The Canadian Chartered Accountant

OFFICIAL ORGAN OF

THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

Published monthly; subscription $3.00 per annum in advance; single copies thirty-five cents. Advertising rates sent on request.

The Editorial Committee will be pleased to receive contributions on subjects of interest. Papers which may not be deemed suitable will be returned, if desired.

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10 Adelaide Street East, Toronto

VOLUME XL — MARCH 1942 — ISSUE NO. 224

(The opinions expressed in articles in The Canadian Chartered Accountant are the opinions of the writers of the articles and are not necessarily endorsed by the Association.)

Editorial Comment

The Auditor of Today

Last month we discussed the significance of the natural business year and the abnormal situation created in the first three or four months of the calendar year by the blind choice of the 31st December as the fiscal year end for the majority of industrial corporations in Canada and the consequent preparation of their annual financial statements at that date. In peace times this bottle-neck in industry had brought to the public accountant long hours of working for his staff and not a few nights of waking for himself. Today the pressure of war has resulted in even more serious problems for the auditor. The call of the government for military service recruits and for members of our profession to fill administrative posts has so reduced the number of experienced men in public accountants' offices that senior members of the staff have been forced to place greater responsibilities on the shoulders of their assistants than was formerly the case.

From this observation the reader must not infer that the junior in the chartered accountant's office is given duties beyond his ability to perform. Quite the contrary; day by day the student in training demonstrates his capabilities—

whether or not he possesses the characteristic traits of an accountant and the infinite quality of taking pains. At the commencement of his apprenticeship an audit programme is placed in the hands of every student, and it is not long before his principal or his senior can gauge the stature and measure the capacity of each assistant, and assign him duties accordingly.

Menace of the Embezzler

With the growth of big business and the rise of great commercial and industrial organizations in recent decades, the possibilities of embezzlement of a company's funds have been multiplied. The managements of corporations have realized this and have provided means to meet the danger. By the internal organization of the company's office and the assignment of specific duties to several individuals much can be accomplished towards prevention of fraud by employees. Such prevention, it should be understood, is an obligation of the administration. When the clever rogue does succeed for a time in defrauding his company, the administration naturally does not want to admit weakness in its organization and must look around for a scapegoat. The auditor of the annual accounts of the company appears to be the most vulnerable person, and in not a few instances in recent years has been called upon to defend himself against a charge of negligence in his duties as auditor.

The attempt to shelve this responsibility on the auditor, and the ingenuity of the embezzler in thinking up new types of fraud and methods of covering up misappropriations of the funds of the company of which the chartered accountant is auditor, add to the worries of the members of our profession. True the schemes of the crook may go undetected for a time, but in due course they are laid bare. Members of the profession, even of long experience, have not always succeeded in uncovering the early manipulations of the thief; they do not lay claim to infallibility, nor are their functions those of a detective. Nevertheless we can understand the daily concern of the public accountant over the performance of his staff, working as they do under the pressure of war conditions. There is the realization that he is liable for the conduct of his employees, that the law of negligence is the same regardless of industrial con-

ditions, and that the lack of competent or experienced help cannot ordinarily be advanced as a defence by an accountant faced with a charge of negligence.

Changes in Audit Practice

In the days when a company's business was of small dimensions, a detailed audit could be performed at a reasonable cost to the client. With the growing magnitude of commercial transactions and the use of labour-saving devices the situation has become entirely changed. The cost to the client of the auditor's services to check all transactions would be prohibitive, so a detailed audit has been considered unnecessary particularly since it is supplemented by a system of internal check. It is understood that the auditor, out of his experience, can use his own judgment as to the extent of the tests which he deems should be made in the examination of his client's accounts. But with the expansion of business already mentioned, the consequent increase in a company's employees and possibly the growing cleverness of such as are dishonest, as well as the effective work of the public accountant, so many cases of defalcation have been uncovered in recent times that it has become natural for the public to think the cause of such thefts due more to the shortcomings of the auditor than to the cleverness of the embezzler. That helps to explain why the auditor in not a few instances has had to defend himself against charges of negligence.

The Law of Negligence

The subject of accountants and the law of negligence was discussed at length two years ago in a series of articles by Messrs. Summerfield and Reynolds of London, England, who are authorities in the fields of Law and Insurance respectively. The series appeared first in *The Accountant*, the publication of the profession of the chartered accountant in England and Wales, and was republished in THE CANADIAN CHARTERED ACCOUNTANT with the kind permission of the editor of that magazine. Offprints of the several instalments in our journal were made and assembled in convenient form, with an index of topics and court cases added, and supplied to the members of our Association. The volume is a most valuable reference and chartered

accountants in public practice will want to keep it as a constant companion.

There is one weak spot in the accounting system of companies which has given rise to disputes as to the responsibility of the auditor and which does not appear to have been dealt with by the authors of that series. In all probability it is a situation that does not arise in other countries and is peculiar to Canada because of what may be termed a weakness in our banking system. It has to do with the verifying of bank deposits, and the matter came into prominence through a recent court action against a firm of public accountants in Montreal. We suggest that members read anew the report of the judgment in the *Guardian Insurance Company* case reported in the February 1941 issue of THE CANADIAN CHARTERED ACCOUNTANT. The auditors succeeded in their defence against the action by that company and by so doing rendered a valuable service to the profession of the chartered accountant.

Bank Deposits and the Embezzler

Members of the profession know that while the chartered banks segregate their customers' cheques and return them to their customers monthly (unless it is a savings account), they do not return the deposit slips, claiming that these are their own private property. However, if the customer has prepared and hands in at the time of making the deposit a duplicate deposit slip, the bank's receiving teller will return this at that time. Unfortunately for the auditor, the bank will stamp a receipt on the duplicate deposit slip to the extent of the correctness of the *total* only—which is equivalent to their giving advice to the customer that the details of the original deposit slip have not been compared by them with the items of the duplicate slip.

This means that the auditor of the accounts of this customer is able only to verify the total amount as having been received by the bank. An embezzler, if part or the whole of his duties is that of cashier, can substitute cheques for equivalent amounts of currency received in cash transactions of the day. He pockets the cash and neglects to enter some of the receipts in the cash book, and by some means not readily discernible to the auditor gets rid of the

corresponding debit for which the cash receipt was payment.

The difficulty of checking or of even making test checks of original deposit slips is apparent. Banks may not wish to go to the expense of employing extra help to segregate deposit slips of their customers. Under such circumstances the auditor as a rule is not in a position even to make a test check of original deposit slips. How then can he be held responsible for making such test? If no test can be made the auditor can only conclude that the cashier is honest until it becomes evident that he is otherwise.

From a reading of the evidence in most actions taken against auditors for negligence and of the arguments brought forward by the plaintiff's lawyers, one can very well ask why every policeman on his beat did not discover and prevent a burglary before it had been committed, and why the medical practitioner is not held negligent because his diagnosis failed to reveal the exact trouble of the patient who came to consult him.

It appears to us that no auditor can be held responsible for not discovering an embezzler's manipulations through misuse of bank deposit slips. The chartered banks might well consider if it is really necessary to retain the original deposit slips in their own files or, as in the case of paid or cancelled cheques, to return these forms to their customers after they have served their purpose.

Prominent Members Pass

During recent months our profession has suffered the loss of a number of outstanding members. In our November issue the Manitoba Institute announced the passing of Robert H. Hayward, who was not only its oldest member but also the last of the charter members of that Institute which was incorporated in 1886. Last month we recorded the death of Mr. A. F. C. Ross, one of the distinguished members of the Quebec Society. This month the Institutes of Nova Scotia and Alberta announce the passing of two members—William E. Leverman and John H. Williams.

Mr. Leverman had reached the remarkable age of eighty-six years and at the time of his death was the last surviving charter member of the Nova Scotia Institute which was incorporated in 1900. During his long life of energy,

integrity and sense of public responsibility, Mr. Leverman did much to lay well the foundation of the profession of the chartered accountant in the Maritime provinces.

From a friendship with John H. Williams that extended over twenty-five years, we can speak more intimately of his work and of his interest in everything affecting the growth of the profession in the province of Alberta. As Secretary of the Institute in that province for many years, he had been closely associated with all its activities and was thus in a position to make a lasting contribution to the development of the profession. Through illness he was forced three years ago to relinquish active participation in professional and Institute affairs, but even to the day of his death he had in his mind and heart the cherished ambition of his twenty-seven years of membership—better training and education of future members of our profession. He was one of the pioneers of the movement for uniform examinations; and well do we recall his happiness and his expression of satisfaction when, at a meeting in Winnipeg in 1938, the Provincial Institutes adopted the plan of uniform examinations for all qualifying as chartered accountants in Canada.

Theirs is a well-deserved rest; the fruit of their labours is monument enough.

THE HUMAN EQUATION IN GOVERNMENT ESTIMATES

By Harry Baldwin, Chartered Accountant, Ottawa

Editor's Note: Mr. Baldwin is a member of the Institute of Chartered Accountants of Ontario and is Treasurer of the Canadian Broadcasting Corporation.

IT would seem that nothing original can be added to the quotations from Marriott and Willoughby which I have selected from "The Mechanism of the Moderate State" (Marriott), Volume I, and "Financial Administration of Great Britain" (Willoughby, Willoughby and Lindsay), and "The Principle of Public Administration" (W. F. Willoughby). These authorities, learned in the law, have said the last word. It remains, therefore, for me to consider only those local conditions and practices which surround federal estimates in Canada and which differ from approximately parallel practices in England. In the word "estimates" I shall include not only the formal annual departmental estimates which go to parliament, but those far more delicate and contentious estimates which are conceived in departments, and passed or rejected by the treasury board whenever so much as a minor clerical position has to be created or filled in any department of the civil service.

Main Estimates

There appears to be nothing particularly mysteriously complicated or unusual about the course of the main estimates from their genesis in the minds of departmental executive officers to their final acceptance or rejection by parliament. The course of estimates runs something like this:

Responsible departmental officials prepare an estimate of all requirements for the ensuing fiscal year, having regard to what it cost to administer the department last year and with a view to the work which is to be done next year. This first estimate is either expanded or contracted by the deputy head of the department, depending on whether or not the deputy head believes that "half a loaf is better than no bread" or, on the other hand, that to ask for too much ensures getting enough. There is no doubt that the making of departmental estimates varies as between departments, and also as between one political administration

and another, but the main policy governing all estimates is determined by the state of the times.

The estimates having been prepared in the department are forwarded to the director of estimates whose traditional duty appears to be that of *advocatus diaboli* for he has, in a sense, to attack the estimates as presented by suggesting reductions which, in the light of his knowledge of other estimates, of other years and of other departments, he feels can properly be made. While the director of estimates has not actually the power to alter estimates, no doubt his comments and advices, as given to the treasury board, are probably the most powerful single influence on the size and form of estimates as considered by cabinet and ultimately submitted to parliament.

Departmental estimates, after having been surveyed by the critical and economical eye of the director of estimates, are laid before the treasury board (which by the way is nothing more nor less than a committee of the cabinet composed of the Ministers of Trade and Commerce, National Revenue, Agriculture, Mines and Resources, and Justice) who no doubt are tremendously susceptible to the advice and comments of the director of estimates.

From the treasury board estimates go to the cabinet where they are discussed and inspected with a degree of attention to detail which is determined by the circumstances surrounding the particular items. The cabinet discussion of estimates must be most interesting and revealing, for it is here that delicate and explosive questions of politics and patronage first receive the breath of life, or are extinguished.

It is true that by far the greater part of estimates are nothing more than annual presentation of obvious necessities, but hardly any departmental estimate can pass the cabinet without provoking controversy and criticism.

When it comes down to cold facts a government's greatest danger is the criticism which may arise out of spending the taxpayers' money on activities which appear to be conceived in the minds of politicians with an eye well open to the fortunes of their supporters inside and outside of parliament. However, governments are no different from companies, or even families, and it is the one who "pays the piper" that "calls the tune." So as long as our present

political system prevails, governments—which means cabinets—will spend the people's money as they see fit, knowing that they are responsible to a house of commons which has an uncomfortable way of ultimately hearing about everything, and that the house in turn is placed there by the people who, however slow they may be, have an opportunity at least every five years of disposing of one government and putting another one in. But we must return to our estimates.

Having passed through the final crucible of the cabinet, having been blessed by the Prime Minister's sigh of brief relief, the estimates are printed and presented to the House of Commons.

In England it is the traditional duty of the Treasury to present the estimates, but in Canada the Prime Minister expects each member of his cabinet to explain, defend and debate the estimates of that department over which he, the cabinet minister, presides.

Estimates are scrutinized by parliament with infinite patience and in intimate detail, and while one may be astonished by the facility with which huge expenditures are authorized, nevertheless the fact that small items arouse storms of debate shows that members of parliament are ever on the alert to exercise their right to criticize the government's actions. And it is the debate on estimates, after all, which reveals in greatest detail the domestic affairs and activities of the government and the civil service.

The passage of estimates through the house of commons in committee of supply having been accomplished through storm and tempest, as well as through interminable doldrums, they are finally voted, and the government receives from the house of commons the right to spend money out of the privy chest and, incidentally, the authority to carry on the business of the country for another year.

Difference between British and Canadian Systems

British System—Under the British system estimates may be said to go directly from the department concerned to the estimate clerk who is a high official of the treasury which makes a very fair examination of these estimates, particularly with respect to any decisions of the treasury which would entail alterations in any estimate from year

to year. Should the estimate clerk be in doubt as to the effect of any treasury sanction, he himself does not deal with the department concerned but refers the matters to the principal clerk in charge of the treasury division which happens to deal with the department concerned, and that officer has usually the opportunity to advise upon any important estimate relating to the departments with which it deals.

Opportunity is also provided for departments to discuss with the treasury, through a principal clerk of a treasury division, any proposed change in estimates, but it would appear that the ultimate decisions rest with the treasury which, in the last resort, may in the exercise of its responsibility present the estimate to parliament in the shape approved by the treasury, rather than as desired by the department concerned.

Canadian System—The Canadian system, as I understand it, is marked by this great difference that estimates, whether officially or unofficially, are discussed in considerable detail at meetings of the cabinet when final decisions as to inclusion or exclusion of items are made. It is true that, theoretically, estimates may be trimmed and criticized by the treasury board with or without the instigation of the director of estimates and that probably the decision of the treasury board still has considerable effect on the reception given to the matter in cabinet, but it is probably the case that in the final analysis a deputy minister must rely on his minister to fight for his estimates at a meeting of the cabinet as well as on the floor of the house.

Estimates Committee

It may be noted that in 1912 there was appointed in England a Select Committee on Estimates (see Willoughby pages 135-140) which functions without any particularly valuable results. It can never hope to have its work up to date; it has no permanent staff; in fact, it seems to be one of those bright ideas blighted at birth with impotence. It is the exact opposite of the public accounts committee which functions rapidly and efficiently with "a servant and helper" in the auditor general himself.

Cabinet Control

I have heard it said that Sir George Murray's strictures

on the amount of detailed work brought to cabinet in Canada are not received with cheers in cabinet circles—some eminent politicians averring that racial differences and jealousies in departments are such as to require the exercise of the combined force of a majority opinion in the cabinet to quash ambitious departmental policies calculated to disturb the *statu quo* which politicians of all breeds and religions are fearful of disturbing.

Special Estimates

In Canada at present the director of estimates also acts as secretary of the Treasury Board (the deputy minister of finance being the nominal secretary). Thus he may be said to hold *all* the keys to the board's favours, and his goodwill is naturally cultivated by departmental officials who may wish to advance or retard policies, promotions and appointments which require the approval of the board.

Policy of Civil Service Independence Reversed

The policy which prompted the government to give the Treasury Board the power to veto the creation of new posts and the making of appointments and promotions requested by departments, and approved by the civil service commission, is of grave significance. In effect the government has deprived the commission of the very powers with respect to appointments, promotions, etc., with which parliament had specifically vested it for the very purpose of relieving the government of what had become a dangerous and embarrassing source of patronage.

THE CONTENT OF MONTHLY AUDIT REPORTS

By Stephen Chan, New York City

Editor's Note—Mr. Chan is a graduate of New York University, a member of the New York Society of Certified Public Accountants and chairman of its Committee on Accountants' Office Procedure, and a member of the National Association of Cost Accountants. He has already contributed to THE CANADIAN CHARTERED ACCOUNTANT, his former article "The Supervision of Accountants' Reports" having been published in our April 1939 issue.

The reader will keep in mind that conditions in Canada are somewhat different from those in the United States. The form of the annual financial statements of corporations must be in keeping with the provisions of *The Companies Act, 1934* (as amended in 1935). Monthly or quarterly reports are not subject to statutory requirements, and the question of individual judgment and test enters into the preparation of such reports.

IT is not my purpose to suggest that a formal report be rendered upon completion of each monthly audit or to declare that every monthly audit report should comprise a letter and comments in addition to financial statements. Nor do I advocate the use of a "standard" or stereotyped form of report. This dissertation is presented as a guide for use or adaptation in those cases where a report is considered desirable.

The public accountant should not overlook the fact that the monthly report he prepares, despite the fact that it may be informal, or labeled "for client's information only," is often used by credit grantors or others, as well as by the client. The accountant should therefore clearly indicate in each report, letter or document he issues, the scope of his examination and any limitations thereof. Since the monthly audit usually does not embrace verification by direct communication or inspection, no formal opinion or certificate should be included in the audit report.

General Principles

The set-up, terminology and classification of the monthly financial statements should conform to those in the year-end report, in order that a clear comparative picture may be obtained by the reader. In this connection the author of *Accountants' Reports** states, "Many a report fails of its purpose because it is not understood, and not infrequently that is the fault of the accountant. . . . The titles of accounts

*William H. Bell, *Accountants' Reports* (Ronald Press, New York).

as they appear on the books should be ignored if they do not clearly convey the desired meaning."

It is not considered desirable to burden the comment section of the report with long tabulations, which may be more clearly presented in separate schedules.

Recommendations and comments on system revision and special matters not directly pertaining to the financial condition or operations should preferably be made the subject of separate letters. It is, in my opinion, extremely important for the accounting firm, large or small, to render in writing all suggestions made to clients. Special letters should be written covering such topics as:

(a) Suggesting the bonding of all employees who handle or have access to cash, securities or merchandise;

(b) The inadequacy of fire or other insurance coverage;

(c) Lack of approval or inadequate control of expenditures;

(d) Suggestions for improving the bookkeeping system or internal control;

(e) Excessive discounts reflected by the cash-books; or any other items arising during the audit, deemed important enough to be brought directly to the client's attention.

The advantages of an exact copy of a letter covering a specific point are obvious when a dispute or complaint on the client's part subsequently arises as the result of any of the foregoing deficiencies in the client's organization or records.

Letter Accompanying Monthly Statements

Before discussing the component parts of the letter or comments accompanying and made a part of the monthly financial statements, it should be understood that the details of such comments, as well as the details of the respective financial statements, will vary with each client and type of business. For instance, it may be noted that:

(a) Hotel reports require detailed statistics as to departmental operations, percentages to sales of food and liquor costs and expenses, occupancy percentages, number of rooms available for occupancy compared with the number occupied, etc.

(b) Reports for coal companies should emphasize both percentages and income and costs per ton, distinguishing

between "yard" and "delivered" sales; and should include a schedule of purchases, sales and inventory by tons indicating types of coal such as nut, pea, buck, rice, etc.

(c) Chain store and retailing reports should indicate percentages of gross profit and expenses to sales, markdowns, inventory turnover, departmental expenses broken down in accordance with the "controllers congress" recommendations, analysis of inventory shortages, inventory and accounts receivable agings, etc.

(d) Brewery reports should set forth income and costs per barrel, should indicate production and sales in barrels as well as dollars, and, when they are sizable compared with production, a section should be devoted to malt, hops and other commodity commitments.

The foregoing items are presented to illustrate the fact that the monthly report should be complete and informative, since its primary purpose is the guidance of the client in the conduct of his business.

Introductory Paragraph—The following paragraph is illustrative of the type of introduction recommended for the monthly report:

> We have made monthly examinations of the books of account of the XYZ Company for the nine months ended 30th September 1941 and in connection therewith submit the following interim statements:

The submitted statements are then listed. However, when the report comprises numerous pages of comments and financial statements, it is preferable to use a separate index preceding the letter. In such event the preceding paragraph will be rephrased to read:

> . . . . and in connection therewith submit the interim statements set forth on the foregoing index.

Scope of Examination—The foregoing paragraph brings out that the report is written as the result of a monthly audit. It does not, however, indicate the scope of the said audit. Since the scope is usually limited as to independent verification of assets and liabilities, the following paragraph is suggested at this point in the letter:

> We have examined or tested accounting records of the company and other supporting evidence, by methods and to the extent we deemed appropriate, but did not confirm the assets and liabilities by direct com-

munication. The inventories, stated at the amount submitted by the management, were not verified.

In trading and manufacturing concerns, the inventory is one of the most important items on the balance sheet; therefore clear comment should always be made as to the manner in which the inventory was determined and the extent to which it was verified by the auditor. If no check of the inventories was made and they are stated at the amounts submitted by the management, it is essential that this fact be indicated.

It is also suggested that undue limitations of the scope of the examination be indicated in this section of the letter, together with any other exceptions or qualifications.

Comments on Financial Condition and Operations—The next section of the letter usually sets forth comments dealing with pertinent changes in financial condition and with the operating results. These comments may include ratios, percentages and unit comparisons.

When significant, sales and purchase commitments should be commented upon or a qualification inserted to the effect that no investigation has been made of these items. Consideration may also be given to orders on hand for future delivery and this data presented in comparative form with the prior year.

Pertinent facts relative to transactions which occur subsequent to the balance sheet date but prior to the completion of the audit are of interest to the client and his creditors. Items such as new bank or other loans obtained shortly after the audit date, collection of receivables, fixed asset commitments, purchases or sales, and repayment of loans may be commented upon.

Monthly Financial Statements

When accompanied by a letter or comments, both the balance sheet and profit and loss statement should bear the legend "subject to the foregoing pages of comments which are made a part hereof."

The profit and loss statement and balance sheet should clearly indicate whether or not provision has been made for Federal (Dominion) income tax on current operations.

The tendency among less meticulous practitioners to set forth on the corporate balance sheet merely the caption

"capital" or "capital stock" is to be deplored. The balance sheet for a small or large corporation, whether the result of a monthly or annual audit, should show each class of stock separately, clearly stating the number of shares authorized and issued, and the par value per share, if any. Cumulative preferred stock should be so designated and any dividend arrears mentioned in a footnote. The surplus accounts should indicate capital or appraisal surplus. Condensation should not be indulged in at the expense of information and clarity.

The monthly profit and loss statement should be sufficiently detailed to emphasize all major variations in income and expenses. For instance, it is preferable, instead of commencing with "net sales," to reflect gross sales, returns, discounts, allowances and net sales.

The profit and loss statement should, whenever possible, be presented in comparative form, illustrated as follows:

Nine Months Ended 30th September				Month of September			
1941		1940		1941		1940	
Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent

Footnotes and Qualifications

It is impractical to set forth all the occasions which require footnotes on financial statements. However, the following suggestions are submitted in this connection.

(a) A new client usually desires comparative statements despite the fact that other auditors, or no auditors, reviewed his accounts in the prior year. Statements of this type should bear a notation such as:

> The figures for the period prior to blank date, stated above for comparative purposes, were not audited by us.

(b) Clients are often stubborn in their interpretation of city, state (provincial) or federal (Dominion) tax regulations, with the result that a contingency exists for possible assessments and penalties on back taxes. This matter may be handled by a note stating:

> The above statement is subject to possible liability for blank taxes for the period from blank date to date, and to possible penalties and interest thereon.

If the amount is determinable an approximation thereof should be indicated in the footnote, or accrual thereof should be made.

(c) In several industries purchases in transit are omitted from the assets and liabilities. In these cases, the notation may read:

> Fall merchandise in transit amounting to blank dollars has not been included in the above inventory or liabilities.

(d) Inspection of correspondence or other sources may reveal pending legal actions, which may be set forth as follows:

> The company is the defendant in a suit for blank dollars for alleged trademark infringement.

Supplemental Schedules and Data

Either as a schedule or as part of the letter, there may be submitted a comparison of the working capital position and an aging of the accounts and notes receivable.

The profit and loss statement may be supported by a schedule of revenue, costs and profit per unit sold or produced.

Sales may be classified by product, salesman or department. It is helpful to submit a schedule showing the sales by months for the current year, compared with the preceding year or years. The schedule should also include the sales for the full twelve months of the prior years, as indicative of the expectations for the remainder of the current year.

When the profit and loss statement contains numerous items, it may be more readily understood and compared if major sections such as "cost of sales," "selling expense," "general expense," and "other income" are presented in separate schedules supporting the condensed statement presented as the main exhibit.

The use of budgets prepared for a year or a season in advance offers an invaluable guide to operating efficiency, and enhances the benefits to be obtained from the monthly report. Where budgets have been prepared, the actual operations should be presented monthly in comparative form with the budgeted figures.

Break-Even Statements

It is recommended that whenever possible the auditor use for statement purposes an actual book, or estimated inventory. However in certain seasonal industries when no inventory figure is made available by the client, it is customary to submit statements based upon an inventory required to reflect neither profit nor loss for the period under review. It is suggested that such statements be prepared in the same detail as that usually employed; accruals should be provided for, and effect should be given to depreciation, bad debts and discounts.

When the "break-even" inventory is used, the profit and loss statement and balance sheet should both include in their headings the phrase, "based upon merchandise inventory required to reflect neither profit nor loss."

On the balance sheet (or statement of assets and liabilities, which caption is preferred by many firms for statements of this type) the required amount of inventory may be shown in the usual balance sheet inventory position; or the following alternative treatments may be adopted:

(a) The inventory may be set forth after the total of all assets excluding inventory.

(b) The assets may be enumerated exclusive of inventory, followed by the liabilities and capital; and thus reflecting as the last figure on the statement the excess of assets, which also represents the required inventory.

On the profit and loss statement, the required inventory may be reflected in one of two methods:

(a) The break-even inventory may be included in the usual inventory position on the statement; the gross profit figure therefore equals the total of the expenses, no net profit or loss being indicated.

(b) The break-even inventory may be reflected as the last item on the statement, being labeled "merchandise inventory required to show neither profit nor loss for the period."

GLIMPSES OF CURRENT ACCOUNTING LITERATURE

A Summary Prepared by John Douglas Campbell, Chartered Accountant

BULLETINS

Cost Accounting

BULLETIN No. 9, Volume XXIII, 1st January 1942, published by the National Association of Cost Accountants covers case studies in the fields of both accounting systems and joint costs.

Edward W. Hartman in an article, "A Simple Hand-Posted Voucher Register System," discusses the operation of a "simple hand-posted voucher register that has proven a time-saver, is flexible in operation, gives more information regarding the source of information than the usual voucher register and can accommodate any number of operators working simultaneously."

The system outlined is based on the use of slips in which a separate slip is used for each supplier. A set of three different coloured slips is prepared for each supplier which slips form the bases of cheque requests, distribution medium and voucher register book of original entry. The detail which is customarily recorded in the voucher register is recorded on each of the individual slips comprising a set.

The article outlines in detail the actual operation of the system and supplements the description with informative exhibits. Special reference is made throughout the article to the nature of the cross checking which is performed to ensure accuracy.

Edward S. Rittler in an article, "A Case Problem in Lumber Costs," discusses the problem of cost determination as applied to the joint products produced by a sawmill under a given set of circumstances.

The article although directed towards a specific problem in the logging industry also gives a detailed explanation of the particular operations carried on within the lumbering industry in general and indicates how certain particular problems (inventory valuation) are met.

Bulletin No. 10, Volume XXIII, 15th January 1942, covers an additional case study in the field of accounting systems with specific reference to accounts payable.

William T. Collins in an article, "Methods Study applied to an Accounts Payable System," outlines using a given case as illustration, the operations of the voucher register system as against the customary accounts payable system.

The article is of value not only because it presents an actual illustration of the application of the workings of a voucher register system as offset against the operation of an accounts payable system but also because it presents a method of procedure in determining necessary changes in systems which might be applied equally well to varying aspects of the accounting records in "eliminating duplication in clerical routines and in the accounting system."

Section III of Bulletin No. 10, Volume XXIII, 15th January 1942, consists of a complete topical index of all technical material which has been published by the National Association of Cost Accountants in its bulletins, year books and special publications from April 1920 to 1st January 1942.

ARTICLES

(1) Accounting Standards

Victor H. Stempf in an article "Accounting Standards," published in the January 1942 issue of *The Journal of Accountancy* (New York), outlines the evolution of accounting principles indicating the important part which accounting research has had in the past and is still playing in this evolution.

In outlining the correlation as between the evolution of scope and principles and changing conditions the writer stresses the significance of the research side of the question suggesting that all new theories should be first tested and tempered by actual practice before they are finally accepted as standards.

An outline of the growth of accounting research under the guidance of the American Accounting Association is presented with highlights on the bulletins of accounting and auditing procedure which have been published to date.

In the outline of the main accounting questions which are at present in the "arena of disagreement" the writer takes recourse to "A Tentative Statement of Accounting Principles Underlying Corporate Financial Statements," a statement issued by the American Accounting Associa-

tion in June 1941 and reviewed in this section of *The Canadian Chartered Accountant* in October 1941. (A copy of this document was recently distributed to all members of the American Institute of Accountants.)

In referring to the statement the following comment is made: "As to its basic assumptions and concepts there can be little difference of opinion; but when the statement ventures into applications of underlying principles, one finds points of disagreement." In covering the "points of disagreement" the items of bond discount, refunding adjustments, surplus adjustments, reserve accounting, creation of paid-in surplus and reacquired shares cover the main "arena of disagreement."

(2) Accounting Systems

Andrew F. Linton in an article "Machine Posting and the Journal," published in *The Accountant* (London) 13th December 1941, outlines the extent to which machine accounting has removed the necessity of certain books of original entry and at the same time has retained the advantages arising from the use of such journals. "In the majority of machine systems the ledger accounts are posted direct from the supporting vouchers thus circumventing the journal and rendering it, in its generally accepted form redundant."

The twofold utility of the former journal both as to the provision of a repository for the double aspects of all transactions and as a medium of analysis is discussed, and the manner in which these aspects are provided for under the machine accounting is set out.

"From a comparison of the old with the new methods of ledger posting it will be seen that there are solid grounds for dispensing with the journal. All the purposes for which it was once used have been embodied in a method of direct posting, mechanical proof, and machine analysis, which has almost extinguished the need for a book of prime entry."

(3) Accounting Principles

DR Scott in an article "The Basis for Accounting Principles," published in the December 1941 issue of *The Accounting Review* (Chicago), places the general concepts of justice, truth and fairness which serve as standards for the judgment of human conduct as the main bases for all accounting principles.

The principle of justice is referred to as the "corner stone so to speak of accounting theory and practice." The principles of truth and fairness are both outlined and placed subordinate to the principle of justice.

In discussing the question of truth special attention is directed towards the concept of conservatism and the statement is made that once conservatism has been accepted as a principle "it ceases to serve its original function of supplementing or implementing the principle of truth. Instead it contradicts the principle of truth and brings confusion into the counsels of the profession."

As the history of accounting has been one of continuous development of both theory and technique the subordinate principle of adaptation naturally arises. In all cases the principle of adaptation should be subordinated to the general principles of justice, truth and fairness.

A concrete illustration of a failure to apply the general principles in respect to adaptation to meet changing conditions is outlined in the specific case of what is termed the use of the "statistical method" in the problem of matching of costs and incomes. "Only by the adoption of such methods (statistical) will accounting adjust itself to the institutional change in business practice whereby the administration of large business enterprise runs in terms of general policies rather than in terms of isolated individual transactions."

The writer feels that the future of accountancy as a science is to be determined on whether the principle of truth will transcend the principle of justice as the cornerstone of accounting theory and practice.

(4) Purpose of Accounting—Interpretation

George O. May in an article "Terminology of the Balance Sheet," published in the January 1942 issue of *The Journal of Accountancy,* responds to the criticisms offered by Arthur C. Kelley and William H. Whitney in their articles which were reviewed in this section in the December 1941 and January 1942 issues of *The Canadian Chartered Accountant.*

The two aspects of utility and accuracy are set out as the underlying reasons why the committee on accounting procedure adopted the procedure of expressing certain definitions in terms of accounting rules, principles and pro-

cedures as against their expression in simple and popular language.

(5) Deficiencies in Financial Statements

William W. Werntz in an article published in the December 1941 issue of *The Accounting Review* and in the January 1942 issue of *The Journal of Accountancy* on "Some Current Deficiencies in Financial Statements" makes an analysis of the deficiencies disclosed by 375 companies whose statements were rejected by the Securities and Exchange Commission as not complying with the regulations as set out under *The Securities Act* (U.S.A.).

Three broad groups of deficiencies were considered:

(1) Deficiencies resulting from violations of explicit requirements of the Securities and Exchange Commission as to content and form of financial statements.

(2) Deficiencies resulting from the violation of the Securities and Exchange Commission's rules governing certification by public accountants.

(3) Violations of generally accepted principles of accounting.

Of the three groups of deficiencies the first two apply to the application of the specific requirements of *The Securities Act* (U.S.A.) and carry interest for those filing returns with the Securities and Exchange Commission.

In discussing the second group of deficiencies the question whether or not a positive description of the work done should be submitted is considered. "We have assumed the existence, not unwarranted I think, of general standards and normal procedures and have required only that departures therefrom be noted specifically and justified. The requirement is based on the idea that departures from normal procedure are more significant than a description of normal procedures followed and are more likely to be given the proper attention if not tucked away in a long and detailed statement of procedures undertaken."

The major deficiency in the third group concerning a violation of generally accepted principles of accounting arose over the question of income determination. Examples of this type of deficiency were considered and specific reference is made to the questions of depreciation on appreciation and extraordinary expenditures.

The question of the creation and use of reserves is considered as a subsidiary deficiency in the third group and specific attention is drawn to the use of reserves which "permit losses to be detoured around the income statement" by the creation of a reserve from surplus and the charging of expenses incurred at a later date against the reserve created.

Inadequate disclosure is listed as an additional deficiency and specific reference is made to the question of the detail disclosed in the surplus account and supplementary data affecting future operations.

The latter portion of the article is devoted to the discussion of certain controversial topics dealing with the question of realization of revenue which have arisen. Specific attention is diverted to the topics of barter and exchange transactions and the provision for income taxes in cases where financial income is materially different from taxable income.

(6) Defense Contracts

Mark S. Massel in an article "Types and Operations of Defense Contracts," published in the January 1942 issue of *The Journal of Accountancy*, outlines the financing, operation and general accounting problems encountered to date in the United States in respect to various types of defense contracts.

The article covers primarily an outline and explanation of the various types of defense contracts under the two divisions of fixed price agreements and negotiated contracts. Under the classification of negotiated contracts fixed price, fixed prices subject to escalator provisions and cost plus provisions are each considered.

Under the escalator provision the government assumes the risk for changes in market prices and wage rates. The same shifting of risks applies to the cost plus contract or its variation, the target price contract; but there also exists in the two later cases the possibility of a reduction in prices if costs decline.

The methods used in the financing of both the working and fixed capital requirements under the defense contracts are outlined. These methods range all the way from complete private financing on the one hand to complete government financing on the other.

The question of the general accounting problems encountered under the various types of contracts is discussed and the place of the accountant clearly defined. "The accountant's contribution can focus upon advising the businessman and the contracting officer on methods of reducing the risks, lowering costs and increasing efficiency. In addition, there is a definite need for providing the contracting officer with cost information to justify the additional amounts which the contractor may desire."

BOOK REVIEWS

Financial Statement Analysis by John N. Myer. Published by Prentice-Hall, Inc., 70 Fifth Avenue, New York City, 1941, 272 pages, cloth, price $3.75.

The object of this book as stated in the preface is "to develop sound principles for a technique of analysis and interpretation of the financial statements of business enterprises."

The author stresses at various points throughout the book the necessity on the part of the analyst of a sound knowledge of accounting processes and he makes a decided effort to illustrate the rightful place of the accountant in the field of financial analysis. The interpretation of financial statements is referred to as the fourth phase of accounting technique,—"It is now considered part of the accountant's work to interpret the statements which he has constructed."

The question of analysis is segregated into two main types, static and dynamic, each of which is developed as to its application to the balance sheet and the income statement. The static analysis covers the relationships existing on a given statement whereas the dynamic analysis covers the measurement of changes in the items on successive statements.

The various tools or devices commonly used in the interpretation of financial statements are considered under each of the different types of analysis. Under the dynamic type comparative balance sheets and income statements, statements accounting for variations in net worth, gross and net profit and the statement of application of funds are considered. In the percentage field under the dynamic type trend ratios (index numbers) and comparative balance

sheets and profit and loss statements indicating percentage increases and decreases are also considered. Under the static type the various structural ratios are developed and illustrated and the use of common size balance sheets and income statements is reviewed.

A special chapter is devoted to the question of standard ratios and their use in which the development of uniform accounting standards and periods is stressed as a necessary prerequisite to the successful preparation of reliable standard ratios.

Throughout the whole of the book warnings are repeatedly posted as to various factors which must constantly be kept in mind in performing any analysis among the more prominent of which are price level changes, and the limitations of financial statements in the fields of valuation, interpretation and the factors which are not recorded on the financial statements. "Everyone realizes that we should measure phenomena which we treat whenever we can and that increasing precision in measurement is a scientific gain. But there is danger that the seductions of statistical technique may blind enthusiasts to the imperfections and inadequacies of the data."

The aim of the author as stated in his preface was "to equip the reader with analytical tools from among which he may later select such as will be most helpful in any work he undertakes." The manner in which this process of equipping is carried out throughout the book is characterized by a conciseness and accuracy of expression supplemented by a wealth of illustration which fully meets the end for which it was devised. This is a book which may well be recommended as a fruitful addition to the library of any accountant.

Fundamentals of Accounting by Robert A. Lamberton. Published by Longmans, Green and Co., 215 Victoria Street, Toronto, 1942, cloth, 478 pages, price $4.50.

Although the interpretation placed upon the term fundamentals in the preface denotes a combination of theory and practice the book proper is devoted to the development of the mechanics of accounting. The book is elementary in scope being designed primarily for a primary text.

The plan of approach followed throughout the book is

indicated in the introduction to the book. "The purpose is simple; it is the writer's wish that the students first view the completed product, after which the finished whole will be taken down part by part. After the several parts have been studied and the student has a good idea where each part fits, then he will be ready to build."

The author in conformity with the above aim adopts the balance sheet approach and confines himself to a development of the elementary aspects of accounting with special stress placed throughout on the mechanics of accounting. The application of the elementary aspects of accounting is considered in reference to the single proprietorship, the partnership and the limited company.

BOND DEFAULTS IN CANADA, 1930-37

By M. S. Hatch and J. L. McDougall, Kingston, Ontario

Editor's Note: Mr. McDougall is Professor of Political and Economic Science at Queen's University and has contributed previously to our pages. Mr. Hatch is a 1938 graduate in Arts of that University.

ONE might perhaps offer an apology for bringing forward now a topic so completely unrelated to the current war effort, but there is a possibility that apologies will ultimately prove to be premature. We must prepare for the peace as well as win the war and if the period 1914-39 is any criterion it may be the more difficult of the two tasks. If democracy is to be preserved it will be as the political organization of a society committed to freedom of enterprise, which is a freedom to try new things, to make losses and to fail, as well as to make profits. No one predicts that the risk and uncertainty in the period after the present war will be less than it was in the twenty years ending in 1939. There may, therefore, be worth-while lessons in the history of bond defaults of 1930-37 which can be applied in the making of financial plans.

The period under study is one in which the strains on economic organization were of an unusual order. It followed one of real prosperity, very substantial investment in real capital, and such abounding confidence in the future yield of equity interests that at the end of the period good equities frequently traded on a lower yield basis than the

bonds of the same companies. After 1929, not only did the price averages fall heavily, but commodity price relationships of long standing were gravely disorganized. Fixed investment fell to such a low level that net investment, after allowing for depreciation was negative rather than positive. While recovery took place between 1933 and 1939 it was in many respects a limited and halting movement. For that reason a general survey of the position of bond defaults in this period is of an especial interest. The social scientist normally complains that he may not experiment, he may only observe what happens and draw his conclusions as best he may. Here is an experiment of a violence which we may hope will not soon be repeated, a test to destruction in which 158 Canadian corporations were the unhappy participants. It is the purpose of this study[1] to summarize as well as possible some of its more important aspects.

In the period 1930-37, bonds totalling $548 millions went into default[2] in interest payments (defaults of sinking fund only were neglected), a sum equal to about one-quarter of all the corporation bonds outstanding.[3]

The distribution by years of the total amounts defaulted presents no unusual features. It is a function of the business cycle. This is true not only of the total, but of the defaults within each class of industry. While there are ap-

TABLE 1[4]

Corporation Bond Defaults in Canada, 1930-37

Year	Par Value		Companies	
	Amount (000 omitted)	Percent	Number	Percent
1930	$ 19,505	3.6	20	12.7
1931	179,874	33.0	30	19.0
1932	227,729	41.8	56	35.4
1933	65,920	12.1	27	17.1
1934	15,307	2.8	12	7.6
1935	20,922	3.9	7	4.4
1936	12,063	2.2	3	1.9
1937	3,262	0.6	3	1.9
Total	544,582	100.0	158	100.0

1. This article is a summarization of Mr. Hatch's thesis *Canadian Corporation Bond Defaults, 1930-37* (Kingston: Queen's University, 1938).

2. The list of companies defaulting was drawn from *The Financial Post*. Thanks are due to the editors of that paper for their co-operation.

3. Estimated at over $2,000 millions by the Dominion Bureau of Statistics.

4. Three companies defaulted, were reorganized and then defaulted again. For the purposes of this study that was treated as one continuing default and was not counted twice.

parent exceptions to that statement in the textile, milling and merchandising industries, they are in each case more apparent than real. 1931-33 saw the great bulk of the defaults.

The marked disproportion between the numbers of companies defaulting in 1930 and the values involved is due to the unusual representation of the real estate companies in that year. Fifteen out of the twenty defaults recorded were of real estate companies and they accounted for half the total value involved. The most probable explanation for their unusual vulnerability is that the industry contained a considerable number of companies in which the junior capital was issued for intangibles only, intangibles of various kinds and of highly evanescent value. Under the first puff of adversity these values disappeared. It is also an industry in which a very high proportion of total costs is constant. Both factors tended to produce an early crop of failures. The corresponding excess of value over the number of companies involved in 1931-32 is due to the very heavy representation in those years of the pulp and paper companies. In value, pulp and paper accounted for 68 and 41 per cent respectively of all the defaults in those years.

Table 2 shows the defaults classified according to the industries affected.

TABLE 2

Corporation Bond Defaults in Canada, by Industries, 1930-37

Industry	Par Value Amount (000 omitted)	Par Value Percent	Companies Number	Companies Percent
Real estate	$ 51,013	9.4	68	43.0
Pulp and paper ..	233,703	42.9	22	13.9
Public utilities .	87,680	16.1	8	5.1
Foodstuffs and beverages	13,958	2.6	9	5.7
Textile	4,984	0.9	3	1.9
Transportation ..	28,483	5.2	6	3.8
Construction	4,259	0.8	6	3.8
Iron and steel ..	36,683	6.7	12	7.6
Merchandising ..	1,681	0.3	2	1.3
Investment trust.	8,977	1.7	3	1.9
Milling	9,235	1.7	4	2.5
Miscellaneous ...	63,926	11.7	15	9.5
Total	544,582	100.0	158	100.0

The unhappy primacy of the real estate industry in numbers of companies affected is again clear, but the weight in value is with the pulp and paper industry, followed at a respectful distance by the public utility industry. Both

of the latter are industries in which the scale of operations is normally very large and both have a very low rate of capital turnover. The result was that when the former was exposed to the full force of the depression practically all the companies in it tumbled down like ninepins. The fact that there were failures at all in the utility industry is not to be taken as a reflection upon its reputation for stability. They prove only that even the most stable industries cannot be safely financed by the issue of bonds alone.

That companies should fail is an inevitable price of change. But once failure has been admitted, the interest of the investor lies in getting a reorganization carried through in the shortest possible time. He may hope to hold his sacrifices to a minimum, but the uncertainty of a prolonged receivership is itself so costly that he is normally willing to make considerable sacrifices in order to terminate it as quickly as possible. It is therefore of interest to note that it took approximately two years to cure the average bond default and that many cases dragged out far beyond the average. Only four of the 47 companies in default at 31st December 1937 had failed in the two preceding years. The worst showing is made by the real estate industry in which there were 32 companies in default, most of them dating from 1930 and 1932. The real estate companies are not alone. There were defaults occurring in other industries in each of the years 1930-33 inclusive which were still uncured at the end of 1937. The distribution by industries is shown in the following table:

TABLE 3
Number of Companies Defaulting, 1930-37, and Still in Default at 31st December 1937

	Number of companies	Par value of bonds (000 omitted)	Percentage of total value	Percentage of par value in the industry
Real estate	30	$ 25,855	17.8	49.8
Pulp and paper .	4	79,115	54.4	33.9
Public utilities .	1	400	.3	.5
Foodstuffs and beverages	2	592	.4	4.2
Transportation .	1	5,000	3.4	17.6
Construction ...	2	1,226	.8	28.8
Iron and steel ..	2	8,274	5.7	20.9
Milling	3	4,614	3.2	50.0
Miscellaneous ..	2	20,329	14.0	31.8
Total	47	$145,405	100.0	

Settlements were arrived at in 111 cases, ranging in value from payment in full including compound interest on arrears to the total destruction of the bondholders' claim. By value, about 73 per cent of all the defaulted bonds had been disposed of in one way or another by the end of 1937. Summarization of the results is nearly impossible. There would appear to be no similarity of reorganization plan within any industry. Each case tends to differ from every other because of differences in the value of the assets, in the astuteness of the parties, and in their bargaining strength. Broadly speaking, seven main groups may be discerned. In 27 cases, adjustments were limited to the interest payable. In three of them, arrears of interest were paid up and the bonds remained outstanding; in twelve, the bondholders were required to submit to a reduction in bond interest without compensation; in seven, they were required to accept a reduction of interest, but were given stock in compensation. The remainder were either compelled to accept stock in lieu of cash in settlement of future interest claims, or else to forego payment of any kind for a time.

In the second group there are six companies which issued new bonds of an increased principal amount in exchange for the old issue. In certain cases, the bondholders received common stock as well.

The third group includes the 26 companies which issued new bonds of the same principal amount, but of diminished security. Usually, general mortgage bonds were exchanged for first mortgage issues, the coupon rate being reduced in amount and payment being made contingent upon earnings. In compensation for these changes, the bondholders were usually, though not invariably, offered stock in partial compensation for their sacrifices, seven companies of this group offering bonds only.

The fourth group includes the 22 cases in which reductions of principal were forced upon the bondholders. The most favourable offer was made to the holders of Ontario Power Service Corporation, who received $90 in bonds of the Ontario Hydro Electric Power Commission for each $100 par value held. The least favourable offer was received by the holders of Canada Power and Paper Corporation issues who received $15 in cash and 1½ shares of common stock per $100 bond.

The sixteen companies of the fifth group settled by the payment of stock, or in some cases, stock plus a small cash payment. In five cases the offer was one of common stock alone. The nine companies of the sixth group paid off in cash only. In seven cases the payments ranged from 1.02 to 64.48 per cent of par. The remaining two issues paid up in full. They were the Price Bros. Company and its wholly-owned subsidiary Price Realty Company.

In the seventh group are those five companies—three real estate, one manufacturing, and one baking company—which failed so miserably that there was nothing left for the bondholders.

Broad as those groups are, there is one case which will not fit into any one of them. Canada Mausoleums, Ltd., offered to exchange a crypt with a regular selling value of $350 for each bond of a par value of $200, on payment of a small cash fee. Information is lacking on the real value of the offer or the enthusiasm of acceptance by the bondholders.

Summarization of this study presents certain difficulties. It has been essentially statistical in nature and the conclusions which it will support are statistical conclusions; true as summarizing the experience of the sample, probably true of the whole population if the sample has been chosen at random, but not necessarily true in their entirety of any one of the cases studied. The most obvious points are the number of cases reported in the study, the amount of the losses incurred in all except a few cases, and the great average length of period between default and reorganization. Beyond that, generalization is a very poor tool. The important facts about the individual default—its duration and its outcome—will be determined by the nature of the case. It cannot be predicted from a general study. The only completely general statement possible is to repeat the warning against the contraction of fixed debt by concerns with fluctuating incomes. It is hardly a novel piece of advice and blandly disregards the reasons why people who will admit the risks run by so doing even if they do not fully realize them still do borrow so in each boom.

* * *

Certain of the social implications of a study of this kind deserve to be explored. During the years after 1930

one heard a great deal of the bloated bondholder and the exaction of his pound of flesh regardless of the effect of such conduct upon the other interests involved. In the light of the picture drawn above it is possible to question its wisdom and its justice. Many of those who bargained for a secure flow of income found it cut off and not resumed, even in reduced amount, until after a waiting period measured in years rather than in months. The bondholder may hope for a greater security than the stockholder, but that security is clearly relative and not absolute.

Even in those cases in which interest payments are not interrupted, it is not proper to argue that the bondholder exacts an undue share of the joint product of industry at the expense of other factors and notably of labour. As recent studies of the national income have shown, the effect of depression is to increase rather than to decrease the share of labour.[5] It is probably true that bondholders as a class go up as against equity holders; but the owners of all capital as a class go down as against labour as a class.

Within those two classes there may be much larger transfers. Those owners of capital who have elected to take strongly protected positions benefit at the expense of the more exposed capitalists. Similarly, the sheltered workers profited very greatly by the depression of 1929-33[6] at the expense of those who went out of employment altogether and of the other weak members of the community; but the losses in depression are losses which fall on both capital and labour.

5. See Colin Clark, *National Income and Outlay* (London: MacMillan, 1937) for data on the experience in Great Britain and the *Survey of Current Business* (Washington: G.P.O., Monthly), June 1940 for data on American experience. See also MacGregor, Rutherford, Britnell and Deutsch, *National Income* (Ottawa: The King's Printer, 1939), p. 33 for the corresponding material for Canada. It would appear to be a universal phenomenon in all capitalistic countries.

6. See John L. McDougall, "The Position of the Farmer in a War Economy," *The Canadian Banker*, April 1941, for data on this shift in Canada.

STATEMENT OF POLICY

on Economies and Simplification in the Production and Distribution of Civilian Goods and the Supplying of Services

Issued by the Wartime Prices and Trade Board
1st February 1942

FOLLOWING the preliminary outline given in its statement of policy on 21st November 1941, the Wartime Prices and Trade Board has commenced a broad programme, covering all fields of civilian trade and industry, for the purpose of effecting every possible economy and simplification in the production and distribution of civilian goods and services. It is hoped that this can be carried out largely through the co-operation of industry itself with the assistance of the Board's Administrators, and under general supervision by a special division of the Board at Ottawa.

Each industry has been asked to nominate immediately an Advisory Committee from among its own members. The Board's Administrators will work with these Committees and formulate general rules for standardization of products, for reduction in the number of varieties, models and styles of goods, and of the sizes and quantities in which they are put up for sale, and for the elimination of unnecessary costs in production and distribution.

In carrying out this programme, industry must work within the field of civilian supply after war requirements have been provided for, in accordance with the regulations of the Director of Priorities and of the various Controllers who are members of The Wartime Industries Control Board in the Department of Munitions and Supply. War production has the first call on the entire resources of the nation. It is the duty of the Wartime Prices and Trade Board and of trade and industry itself to see that the most efficient possible use is made of the remaining resources available from time to time for civilian supply. More specifically, the objectives of the programme are:

1. To secure a greater total amount of civilian production in relation to the human and material resources available after the needs of our armed forces and of our allies have been met;

2. To obtain a greater production of necessary civilian goods through a corresponding reduction in the production of unnecessary civilian goods;

3. To reduce substantially unit costs of operation of manufacturers and merchants and enable subsidies to be avoided or reduced in amount;

4. To ensure continued and orderly civilian supply;
5. To obtain more effective control of prices and costs.

The underlying reason for such action is the same as that for price control itself, namely, the growing needs of the armed forces and of our allies, and consequent shortages in both material and human resources for civilian production and distribution. These shortages have been accentuated recently by the loss of certain external sources of supply, but the main reason why civilians must exert every effort to make the best possible use of available civilian supplies is the constantly accelerating war programme. Of special importance in the coming months are the growing shortages in industrial capacity and manpower—shortages, that is, relative to the expansion in total war and civilian demand.

The general principles of this programme apply not only to manufacturing industries but also to retail and wholesale trade and the service industries. Retail and wholesale merchants will, in addition, benefit from the measures taken by manufacturers. Thus, where the retailer has shared in the burden of higher manufacturing costs by accepting higher manufacturers' prices, reduction of such costs may reduce the cost of merchandise to the retailers; similarly, stocks need not be so large, and will be turned over more quickly, as a result of reductions in varieties; cessation of changes in models will reduce the necessity for "mark-downs;" unit sales costs may be substantially reduced. In what follows, however, attention is centred particularly on manufacturers. The following are illustrations of the kind of measures contemplated:

1. In many industries a great deal can be done by reducing the number of varieties, styles, sizes, etc., of articles for sale. Standardization to a degree never possible or desirable in peacetime must be vigorously sought under present conditions.

In following this approach, higher-price and higher-cost lines should be eliminated wherever such action will enable any given amount of labour, materials and power to produce a greater total volume of production. Each manufacturer can simplify his own lines and, to a certain extent, there can be uniformity among all manufacturers in an industry. There should be concentration on standard price ranges suited to mass demand. New models or varieties should be produced only where this can be done more cheaply or where it is necessary because of substitute materials or, in the case of women's clothing, where style changes are to some degree followed even under present conditions.

2. Each industry can simplify the materials it buys as well as the articles it sells, and can economize in buying as well as in pro-

duction and selling. Wherever production facilities of supply sources permit, there should be concentration on the purchase of larger quantities of fewer varieties of materials. Buying may be pooled and long-term, mass quantity, fixed-price contracts are possible in certain lines.

3. Unnecessary "frills" by way of ornamentation and decoration of goods, fancy packages and wrapping may be eliminated without affecting consumer value. In some cases, to be strictly controlled by the Administrator, less valuable but equally serviceable materials can be used, at less cost to manufacturers and without prejudicing consumers.

4. Costs incurred previously for reasons of competition, goodwill or prestige are becoming less and less justifiable under present conditions. Duplication of sales efforts and overlapping of markets may be avoided in a number of cases. For instance, it is obviously costly, not only in money but in urgently needed transportation facilities, for goods produced in Montreal to be shipped for sale in Toronto, while similar goods produced in Toronto are shipped to Montreal.

THE WARTIME PRICES AND TRADE BOARD

Official Documents in Effect at 14th February 1942

We publish below a list of the official documents of the Wartime Prices and Trade Board in effect at 14th February with which members of the profession may wish to be familiar. We are indebted to Mr. A. M. Henderson, Assistant to the Chairman of the Board, for checking the list at that date.

Mr. Henderson informs us that the Board has in mind preparing a booklet setting forth the basic orders in council, orders of the Board and other memoranda in connection with its operations, but that it will be some little time before such a booklet can be issued.

Orders in Council

P.C. 8527	1st November 1941	The maximum prices regulations
P.C. 8528	1st November 1941	The wartime prices and trade regulations
P.C. 8818	11th November 1941	Amending order in council 8527
P.C. 8965	21st November 1941	The maximum rentals regulations
P.C. 9029	21st November 1941	The wartime leasehold regulations
P.C. 571	26th January 1942	Amending orders in council P.C. 8527 and 8818

Orders of the Board

No. 66	26th November 1941	Manufacturing processes performed on a custom or commission basis, designated as "services" under maximum prices regulations
No. 74	16th December 1941	Respecting maximum rentals and termination of leases

No. 75	16th December	1941	Respecting consumer credit (replacing order No. 64 dated 10th October 1941)
No. 76	16th December	1941	Setting forth powers of administrators
No. 78	23rd December	1941	Respecting licenses
No. 85	13th January	1942	Amending Order No. 74 respecting rentals, etc.
No. 87	13th January	1942	Amending Order No. 75 respecting consumer credit
No. 91	20th January	1942	Authorizing the administrator of retail trade to adjust maximum prices on sales at retail in specific cases
No. 92	20th January	1942	Respecting rail rates
No. 93	24th January	1942	Respecting sugar rationing
No. 96	3rd February	1942	Services of optometrists and opticians designated as "services" under maximum prices regulations.

Note: In addition to the above, many other orders of the Board have been issued in respect to the prices of specific commodities and other matters.

Statements of Policy

21st November	1941	Preliminary statement of policy
24th November	1941	Statement on the importance of all accounting and other records
2nd December	1941	Prices of new goods (published as an appendix to Order No. 76)
1st January	1942	Statement on import policy (published in *The Canada Gazette* on 29th December 1941 and summarized in *The Canadian Chartered Accountant* for February 1942)
1st February	1942	Policy statement—Economies and simplification in the production and distribution of civilian goods and the supplying of services (published in *The Canadian Chartered Accountant* for March 1942).

In addition to the above the Board has published the following pamphlets entitled:

17th January	1942	Retailers' bulletin, number 1
26th January	1942	Retailers' bulletin, number 2
20th January	1942	Wholesalers' bulletin, number 1
21st January	1942	Seeds administrators' bulletin, number 1
12th February	1942	Furniture dealers' bulletin, number 1, in which are set out matters of general interest to the public, retailers and wholesalers.

AUDIT OF SUB-CONTRACTS

The Department of Munitions and Supply

Order in Council P. C. 455

(21st January 1942)

HIS EXCELLENCY
THE GOVERNOR GENERAL IN COUNCIL:

WHEREAS by Order in Council number 9159 dated the 26th day of November 1941 it is provided as follows:

(1) Where the Minister of Munitions and Supply enters or has entered into a contract for the production of munitions of war or supplies, or for the construction or carrying out of any defense project or the repair, maintenance, storage and/or servicing of munitions of war or supplies and such contract is on the basis that the contractor is to receive the cost of performing the work plus a profit or fee and where such contractor sublets part of the work, the Minister of Munitions and Supply may either before or after the completion of the work audit the records of any sub-contractor to ascertain if such sub-contractor, in addition to his costs (as determined by the Minister of Munitions and Supply), is receiving or has received for the work done by him a profit in excess of a fair and reasonable profit; and if the Minister of Munitions and Supply ascertains such to be the case the sub-contractor shall upon the demand of the Minister refund the amount of such excess and in the event of such refund not being made forthwith after such demand the Minister may sue for and recover from such sub-contractor such excess profit and the cost to the contractor shall be deemed to be reduced accordingly and the accounts between His Majesty and the contractor shall be adjusted to give effect thereto.

(2) The term "sub-contractor" as used herein shall include any person engaged to do any part of the work to be performed under any such contract entered into by the Minister as aforesaid.

(3) The above provisions shall apply to all such contracts and sub-contracts hereafter entered into or let and all such contracts and sub-contracts entered into or let since 9th April 1940.

AND WHEREAS the Minister of Munitions and Supply

deems it necessary for the more efficient operation and enforcement of the said provisions that the procedure hereinafter set forth be established.

THEREFORE, His Excellency the Governor General in Council, on the recommendation of the Minister of Munitions and Supply and under the authority of The Department of Munitions and Supply Act and The War Measures Act, is pleased to order and doth hereby order and direct,—

(1) That every auditor of a sub-contractor as defined in P. C. 9159* (and any amendments thereto) shall, if so directed by the Minister of Munitions and Supply (hereinafter called "the Minister"), within the time limit fixed by the Minister in such direction submit to the Chief Cost Accountant, care of the Department of Munitions and Supply, a detailed statement of the cost to the sub-contractor (made up in conformity with the Costing Memorandum, being Form M. & S. 433 of the Department of Munitions and Supply, or on such other basis as instructed by the Minister) of the work performed by such sub-contractor under the contracts specified in the Minister's direction; and also showing the aggregate of all billings by the sub-contractor for said work.

(2) That every such detailed statement shall be made up in conformity with such instructions as the Chief Cost Accountant for the Department of Munitions and Supply shall issue for such purpose and shall be accompanied by such documents, certificates, and/or other records as the said Chief Cost Accountant shall require.

(3) That every auditor who shall perform any services pursuant to any direction given by the Minister hereunder shall be paid by His Majesty such remuneration for performing such services as in the opinion of the Minister may be considered fair and reasonable.

(4) That the term "Auditor" as used herein shall include any firm or association of auditors.

(5) That failure to comply with any of the foregoing

*P. C. 9159 empowers the Minister of Munitions and Supply to recover from any sub-contractor who is engaged to do any part of the work to be performed under any contract entered into by the said Minister, any amount whereby the moneys received or to be received by such sub-contractor exceeds the cost of the work (as determined by the Minister) plus a fair and reasonable profit.

provisions shall constitute an offence under the Department of Munitions and Supply Act.

(6) That the provisions hereof shall be in addition to, and not in substitution for the provisions of Order in Council P. C. 9159, of 26th November 1941, and any amendments thereto.

ECONOMIC NOTES

Production for Victory

Editor's Note: This is another in a series of notes on current economic subjects by Lawrence B. Jack, M.A., Montreal.

PRESIDENT Roosevelt's budget for 1943 is one item of really good news for the Allied Nations this year. His message to Congress showed that the Administration has fully realized the nature and extent of the task before the Allies. Provision for $60 billions, plus a warning that this sum might be increased any time by unspecified but unlimited amounts, shows that the United States is firmly resolved to be limited in her war effort only by her capacity to produce (assuming always that this almost unbelievably large governmental expenditure will not be dissipated by inflationary price increases).

Since the sum of $60 billions is quite incomprehensible even to people accustomed to juggling the interminable zeros which appear in peacetime government finances, it is helpful to translate the budget into its potential production terms. The President hoped that this sum would provide by the middle of 1943 a total of 60,000 planes, 45,000 tanks and at least 8 million tons of shipping. And if it is said that these figures are impossibly high, the only valid answer would be that these armaments will not be too much, if indeed they will be enough. To get them, steel capacity must be increased from 86 million to 99 million tons, plus a 16 million ton increase in pig-iron capacity. Aluminium production is to be doubled from its present level of 600 million pounds, and magnesium output is to be multiplied five times to over 160 million pounds. Machine tool output, the perennial bottle-neck, is to be raised from $750 millions to $2 billions, which will be very close to

ten times the 1939 output. Moreover, all these increases and many more as important if not as spectacular are at least theoretically possible, since in the previous two years the United States has gone a long way in developing effective armament production techniques.

Reactions to this staggering programme have been widely varied, but two items are worthy of comment. One cannot help but be impressed by the note of rage, exasperation and defeatism underlying the thin veneer of simulated contempt and claims of impossibility which make up German comments on the American war production plan. Perhaps the Nazis remember that declaration of Hindenburg that mobilization of America's industrial capacity during 1917-18 shattered any illusions of a German victory: "That brilliant, pitiless industry entered the service of patriotism and did not fail it. They understood war." On the other hand, an important number of people in the Allied Nations seems to feel that because the appropriations have been voted, the armaments are virtually in existence. In other words, too many still believe that it is possible to buy victory.

These people seem to have forgotten that for many months before the attack on Pearl Harbour, the United States, for all practical purposes, was in the war with nearly all the weapons she had ready at the time. As a result of the first Japanese attack, to say nothing of their later victories, the balance of armaments was abruptly altered in favour of the Axis and in the democracies' disfavour. Thus there is still a tremendous back-log to catch up before parity, let alone superiority in armaments, can be achieved. Further, as *The Economist* (London) has phrased it, "The hard and unpleasant fact is that production of munitions requires a great deal besides human effort and material supplies—it requires planning, building, the provision of machines, incredibly complicated coördination of the flow of production—above all, it requires time."

Although expansion of armaments and production is a slow and difficult business, the increased need for it is immediate and enormous—and rising all the time. Moreover, for a multitude of reasons, grievous bottle-necks persist in holding up production. Thus, shortages of steel scrap prevent ingot operations from rising above the 98% level, although a theoretical 110% is possible at least for short

periods. And when one bottle-neck is widened, others take its place: by stepping up deliveries of structural steel, shapes, bars and plates to shipbuilding and new plant construction a shortage has been developed in railway freight car building. The result is that transportation may be lacking to move the flow of munitions once it comes in full flood. Again, there is a problem of labour supply now that armies are being increased and the necessity of training replacements from sub-par or young workers becomes evident. Yet the time is short; as Donald Nelson, Chief of the War Production Board, has said: "one gun now is worth ten in 1943." Therefore, it is not enough now to float huge war loans successfully unless an immediate attack on production problems is also successfully carried out.

As stated before, within reasonable limits America's physical resources of labour, materials and plant capacity are clearly available to meet the projected armament programme either now or within a reasonably short time. But if advantage is to be taken of the vital time factor, the real *economic* problem now facing the United States is the diversion of productive capacity not now involved in armament production. Already an excellent start has been made by prohibiting manufacture of automobiles and brutally cutting the production of other consumer durable goods. The process should go infinitely further, however, to embrace simplification of those consumer goods which are still available. Reduction in numbers of styles and qualities will enable concentration of consumer goods' industries with attendant release of men and factory space, and sometimes of machines. And unless such ruthless curtailment of consumer supplies and services can be extended in ways not even suspected now by plant owners, the precious time factor will be largely lost.

What has been said of the United States is quite as much, if not more applicable, to Canada and the other Allied Nations. In Great Britain, for instance, even the London "Times" now agrees with Mr. Bevin that armament industries could produce 40% more than they do now. Certainly in Canada we still engage in lines of production which do nothing directly to add to the war effort, although they do supply comforts to consumers and fortunes to their owners. In other lines we are still providing services and

satisfactions which necessarily absorb labour and factory space that might be better utilized elsewhere. For example, until the civilian population is wearing nothing but overalls it will be hard to insist that the maximum amount of production factors has been released for war purposes from the clothing industry. Of course there may be many incontrovertible reasons why such a drastic step might never be necessary, but this example at least shows the type of rationalization, simplifying and streamlining of civilian production that should be aimed at if a maximum war effort is to be had.

Montreal,
17th February 1942.

TABLE OF EXCHANGE RATES

(Kindly supplied by The Canadian Bank of Commerce, Toronto)

	31st January 1942	*15th February 1942*
U.S. Dollars	10-11% P.	10-11% P.
Sterling	443-447	443-447
Australian Pounds	358½	358½
New Zealand Pounds	360	360
South African Pounds	443	443
British West Indian—Dollars	9270	9270
India—Rupees	3358	3358
Hong Kong—Dollars (Custodian rate)	2781	2781
Straits Settlements—Dollars	5204	5180
Sweden—Kronor	2637	2637
Switzerland—Francs	2569	2569

Note: The above currencies are expressed as follows: Pound currencies—Canadian cents per unit; Continental currencies and sundry British Empire—Canadian cents per 100 units.

TRANSPORT IN GREAT BRITAIN

We have received a copy of the Journal of the Institute of Transport in Great Britain which contains the address of the President, J. S. Nicholl, C.B.E., C.A. (Saskatchewan), given at the meeting of the Institute on 13th October last.

After dealing with the development of road transport and the several legislative acts bearing on such aspects of the industry as road and rail traffic and road haulage wages, Mr. Nicholl made the following observations on road transport and the war which will be of interest to our readers:

"During the War, in common with many other industries, the road carrier has had innumerable complications with which to contend. Blackout, blitz, lighting restrictions, shortage of spare parts and of replacement vehicles, shortage of experienced staff, loss of many skilled men (not only to the Forces but to munition plants with their attractive pay and conditions), petrol rationing, requisitioning of vehicles by military and civil authorities—these are only some of the difficulties he has had to surmount; and, in spite of them all, I think he can claim to have responded in full to every demand and, on no occasion, to have let his country down. It has been an epic of individual energy and resourcefulness and there is something intensely British in the manner in which the staffs of these carrying concerns have stood to their job under conditions which would have daunted many. Because of the unremitting pressure of work and the fact that these men are not encouraged to talk about their job, comparatively little has been heard by the general public of their achievements. To those of us whose privilege it has been to be in daily contact with them, the thing which most deeply impresses us is, perhaps, not even so much the courage they have displayed under conditions of danger, as the calm way in which they have gone ahead with the job so that, whatever else happened, the service should be kept running and the goods safely delivered. . . . War is a testing time for many things; if any proof were needed, it has proved once again and beyond all question the vital part which road transport plays in the very existence of the Nation in time of peril."

GENERAL NOTES

Mid-Year Final Examination

The Board of Examiners-in-Chief of the Provincial Institutes of Chartered Accountants announces the holding of a mid-year Final examination in 1942 during the week of 1st to 6th June. This examination does not replace the annual one which will be held in December next. The hours of writing are from 9 a.m. to 1 p.m. on the following days:

1942	*Subject*
Monday, 1st June	Auditing I
Tuesday, 2nd June	Auditing II
Wednesday, 3rd June	Accounting I—Accounting, including business investigations
Thursday, 4th June	Accounting II—Accounting including costs, budgetary control and systematizing
Friday, 5th June	Accounting III—Accounting, including consolidations, executorships and trusteeships
Saturday, 6th June	Accounting IV—Accounting, General

Index Figures of Living Costs

According to the Dominion Bureau of Statistics, the index number of living costs declined from 115.8 on 1st December 1941 to 115.4 on 2nd January 1942. This index, which has been specified as the basis for calculating cost-of-living bonus adjustments under Order in Council P.C. 8253, has increased 14.5 per cent between August 1939 and January 1942. (Previous reference—page 126 of February issue.)

Dominion Income Tax Revenue

According to *The National Revenue Review* for February 1942, the net collections of Dominion income tax for the ten months ending 31st January 1942 were $494,440,563, or an increase of $291,834,965 over the collections for the corresponding period ending 31st January 1941.

The increase in revenue arising from customs duties and from excise taxes and duties for the ten months ending 31st January 1942 over the corresponding period of a year ago was $183,831,386.

The Excess Profits Tax

Uncertainty as to the nature of the final assessment under *The Excess Profits Tax Act* is reflected in certain instances in qualifications of the auditor's report to the shareholders. The following extracts are taken from published reports for 1941:

(a) *The Crow's Nest Pass Coal Company Limited*

". . . . Full provision has been made for Federal Income Tax. Provision has also been made for the Excess Profits Tax which it is considered will be assessed against the Company, but the adequacy of this provision is subject to a satisfactory ruling by the Board of Referees on the Company's application for a Standard Profit as provided by Section 5 of The Excess Profits Tax Act . . . ."

(b) *Algoma Steel Corporation Limited*

". . . . In our opinion, subject to the adequacy of the provision for Excess Profits Tax the above balance sheet . . . ."

(c) *Commercial Alcohols Limited*

". . . . Subject to the final determination of the company's liability for income and excess profits taxes by the Department of National Revenue, in our opinion the above . . . ."

(d) *Canadian Industrial Alcohol Company, Limited, and Subsidiary Companies*

". . . . The adequacy of the Provision for Taxes on Income is subject to the final determination of Income and Excess Profits Taxes payable, but the existing reserves are considered, in the aggregate, to be sufficient to cover any additional taxes that might finally be assessed . . . ."

(e) *Canadian Car & Foundry Company, Limited*

". . . . Provision has been made for Income and Profits Taxes in respect to the current year's operations of the Company and its subsidiaries in amounts considered by the management to be sufficient and this provision is subject to final determination by the Income Tax Department . . . ."

Partners' Salaries and Excess Profits Tax

According to Hon. Mr. Ilsley (House of Commons, 6th February) the Department of National Revenue has now made clear the position of sole proprietorships and partnerships in respect of the minimum standard profit of $5,000. The section of *The Excess Profits Tax Act* providing for this minimum will be interpreted as allowing the minimum to apply after rather than before the deduction for reasonable salary.

"Standard Period" and Excess Profits Tax

According to Hon. Mr. Ilsley (House of Commons, 6th February) it is anticipated that *The Excess Profits Tax Act* will be amended at the present session of Parliament to define "standard period" for those companies which commenced operations after 1st January 1939. Such companies will have to apply to the board of referees for a determination of their standard profit.

A verbatim copy of Mr. Ilsley's announcement in respect of partners' salaries and of the standard period was sent by the Dominion Association to the reference library of each Provincial Institute on 9th February last.

Population of Canada

The population of Canada has increased 10 per cent within the past ten years and according to the 1941 decennial census is now 11,419,896. Census figures for Canada since 1871 when the first count was made are as follows:

1941	11,419,896
1931	10,376,786
1921	8,787,949
1911	7,206,643
1901	5,371,315
1891	4,833,239
1881	4,324,810
1871	3,689,257

The area of Canada in square miles is greater than that of the United States which has a population of about 137 millions.

Dominion Prize Winners in the December 1941 Examinations of The Provincial Institutes of Chartered Accountants

E. D. Berry (Ontario) | W. H. Gray (Manitoba) | N. M. Crute (British Columbia)

Effingham Deans Berry, Ottawa, a candidate of the Institute of Chartered Accountants of Ontario, was awarded the Gold Medal and cash prize of $50 of The Dominion Association of Chartered Accountants for winning first place in Canada in the Final examination conducted in December 1941 throughout the Dominion by the Provincial Institutes of Chartered Accountants.

William Hamilton Gray, Winnipeg, a candidate of the Institute of Chartered Accountants of Manitoba, obtained the second highest standing in the Dominion Final examination and was awarded the Silver Medal and cash prize of $25 of The Dominion Association of Chartered Accountants. Mr. Gray is a graduate in Arts and in Commerce of Queen's University and had a distinguished career as a student there, having won the P. D. Ross Scholarship in Commerce of the value of $150.

Norman Matthews Crute, Vancouver, a candidate of the Institute of Chartered Accountants of British Columbia, won the Silver Medal and prize of $25 of The Dominion Association of Chartered Accountants for standing first in the December 1941 Intermediate examination of the Provincial Institutes. Mr. Crute has been serving in the Officers' Training Corps of the University of British Columbia.

Canadian Sterling Balances in London

According to *The Economist* (London) of 3rd January 1942 Canada ranks among the largest accumulators of sterling balances in London.

Up to 31st March 1941 the deficit of the United Kingdom in regard to Canadian purchases amounted to $795 millions. This amount was settled by a transfer of gold to Canada amounting to $250 millions, a repatriation of Canadian securities of $337 millions and an accumulation of sterling balances for the balance of $208 millions. In the seven months ending 31st October 1941 there was an additional deficit of $613 millions which was settled in part ($175 millions) by sales of British-owned Canadian securities and the balance of $438 millions by an increase in the accumulation of sterling balances.

The sterling funds in question are reputed to be invested in the form of treasury bills.

Tax Reserve Certificates

Tax reserve certificates have been issued by the British government which are designed to be used in payment of income tax, surtax, national defence contributions, excess profits tax, and land tax. If the certificates are used for this purpose they earn a rate of 1 per cent per annum which interest will not be subject to income tax. The investment in tax reserve certificates is considered as additional capital in the computation of the excess profits tax.

Inflation Potential

M. S. Szymczak of the Federal Reserve Board of the United States in commenting on the matter of inflation points out that if sharp price increases are to be avoided either price ceilings must be fixed supplemented by rationing or an aggressive fiscal policy be adopted supplemented by monetary controls sufficient "to divert from current income enough funds to keep consumers from demanding more goods than are available at present prices." He makes the further observation that if price ceilings are set and people are left with increased incomes to spend, the job of rationing must follow if the limited supplies are to be distributed fairly.

LEGAL DECISIONS

[Editor's Note:—The following are brief summaries of recent decisions of the Canadian Courts as taken, by the kind permission of the Canada Law Book Company, from the *Dominion Law Reports*. In each case reference is made to the volume of the *Reports* where the full judgment may be found. It should be kept in mind that the decisions given may not in every case be final.]

Bank deposits unclaimed—Right of Province to claim title to under Vacant Property Act (Quebec)

(Attorney General v. *Bank of Montreal)*

Quebec Superior Court

Section 1 of the *Act Respecting Certain Vacant Property*, 1939 (Quebec), c. 28, which provides that deposits in credit institutions which remain unclaimed for thirty years or more shall be deemed to be vacant property belonging to the Province, applies to bank deposits. The subject-matter of the Act is not banks and banking but *bona vacantia* and property within the Province, and it does not conflict with the provisions of s. 92 of the *Bank Act*, 1934 (Canada), c. 24, which merely remove claims for recovery of bank deposits from the operation of laws of prescription, nor with those of s. 115, the effect of which is merely to require the Minister of National Revenue (Dominion) to retain such bank deposits as remain unclaimed by those entitled on the winding-up of the bank but which give him no right to such moneys. The provincial statute is accordingly *intra vires*.—[1942] 1 D.L.R. 309.

Appeals Dismissed

The appeal to the Supreme Court of Canada of The Montreal Light, Heat & Power Consolidated and that of The Montreal Coke & Manufacturing Company from the decisions of Mr. Justice Maclean in the Exchequer Court of Canada were dismissed on 3rd February. A copy of the reasons for judgment in the Supreme Court has been sent by the Dominion Association to the reference library of each of the Provincial Institutes of Chartered Accountants. (Previous reference—page 125, February 1941 issue.)

PROVINCIAL NEWS

ALBERTA

The Institute of Chartered Accountants of Alberta announces that, subject to the formal approval of the Senate of the University of Alberta, the following are the successful candidates of the Institute in the December 1941 examinations:

Primary—Harvey W. Bliss, Allen L. Crummer, Dorland H. Fowler, Ian L. Morrison, W. G. H. Robinson, Lorne R. Roberts, Harry F. Sced, James F. Wilson.

Intermediate—Elvin A. Christenson, Albert P. Friesen, Harold F. Herbert.

Final—Fred O. Delay, Alexander J. Hamilton, Kenneth L. MacFadyen, James E. Paterson, William H. Power, Clarence A. Richards, R. J. Snell, Gordon W. Stewart, H. G. Thomson, William C. Willetts.

The following candidates were successful in Final Law: John M. Meikle and George E. Mowat.

Prizes—Subject to the approval of the Council of the Institute, the following are eligible for prize awards: Final—gold medal, Alexander J. Hamilton; Intermediate—silver medal, Harold F. Herbert; Primary—bronze medal, Ian L. Morrison.

BRITISH COLUMBIA

The following candidates of this Institute were successful in the December 1941 uniform examinations in the subjects of Accounting and Auditing of the Provincial Institutes of Chartered Accountants. The honour of standing highest in Canada in the Intermediate examination belongs to N. M. Crute. The names are arranged in order of merit.

Final—K. C. Bruce, G. F. Dunn, J. A. McIntyre, G. M. Miller and H. G. Watson.

Intermediate—N. M. Crute, G. W. Carlisle, S. N. Crowther, R. A. Stubbs and S. E. Thorne.

The following candidates were successful in the Institute's examination in Law:

Final—A. H. Affleck, W. T. Powers, S. S. McLaren, A. M. Reid and J. E. Robertson.

Intermediate—R. A. Stubbs, N. M. Crute, G. H. Brickwell, G. W. Carlisle, R. W. Gross and S. E. Thorne.

MANITOBA

The Institute of Chartered Accountants of Manitoba announces that the following are the successful candidates of the Institute in the uniform examinations of December 1941, set throughout the Dominion by a joint committee consisting of representatives of the Provincial Institutes of Chartered Accountants in Canada.

Final: William Hamilton Gray, who secured second place in Canada, was awarded a Silver Medal and Prize of $25.00 by The Dominion Association of Chartered Accountants. For ranking highest amongst Manitoba candidates, the Institute awarded him the War Memorial Gold Medal (endowed by the late T. Harry Webb), and a Prize of $100.00. Prizes of books were awarded to Jack Tottem Ellis and Reginald Heber George Walton.

The list of successful candidates in the entire examination follows: Edgar Maunsell Baldwin, William Gordon Dunbar, Jack Tottem Ellis, David Allan Gilman, William Hamilton Gray, Gordon Ward Hunter, William Angus Irvine, Peebles Kelly and Reginald Heber George Walton.

The following candidates were granted supplemental standing: Osborne Edward Hawkins, Paul Kenway, Frank Charles Moncrieff, James Victor Steele, George Norman Wildgoose and Robert Kemp Williams.

Intermediate: John Rawson Barker, who secured first place amongst Manitoba candidates was awarded the W. A. Henderson Silver Medal, and a Scholarship of the value of $50.00. The following candidates passed the entire examination: Morley Arnaud, John Rawson Barker, Thomas Edward Brown, John Wilmot Corbett, John William Crowe, Roy Arthur Dingle, Henry Harold Floyd, James Arthur Hillman, John Charles Kost, Edwin Campbell Lamont, Clarence Sidney Nicholl, Donald Baxter Rankin, William George Spalding, Alexander Tadman and Geoffrey Herbert Ward.

ONTARIO

The Institute of Chartered Accountants of Ontario announces the following results of the examinations in the Primary, Intermediate and Final grades held in December last. Candidates in the Intermediate and Final grades wrote the uniform examinations of the Provincial Institutes

of Chartered Accountants. E. D. Berry of Ottawa won the gold medal awarded by the Board of Examiners-in-Chief of the Provincial Institutes for the highest standing in Canada in the accounting and auditing papers of the Final examination. One hundred and seventy-seven candidates were successful, of whom sixty-four wrote the Primary; fifty-seven the Intermediate and fifty-six the Final examinations.

Primary: C. J. Bailey, M. Birstein, R. A. Blair, F. C. C. Boland, G. H. Boody, E. D. Botsford, D. H. Bradley, J. L. Burnham, D. K. Cameron, H. B. Capell, V. H. Chadwick, B. B. Chapman, W. J. Coleman, W. B. Coutts, J. B. Crammond, A. F. Davis, Bert T. Day, F. L. DeGuerre, J. M. Donovan, Arthur Duncan, J. A. Edds, L. C. Farris, J. C. Filman, J. Gluskin, Harvey Hacker, D. M. Haig, G. M. Hamill, H. C. Haney, Samuel Hauer, J. Hershoran, L. E. Johnston, J. G. Lever, H. W. Littleford, H. S. MacDougall, K. D. MacLennan, Saul Marks, C. W. Milner, A. A. McMichael, R. G. Nesbit, G. I. Newman, W. R. Ofield, K. R. Oswell, Andrew Pal, T. M. Plewes, R. E. Pogue, Irving Reiss, F. G. Robertson, J. P. Robertson, E. C. Robinson, J. D. Rogers, W. A. Smith, W. J. Snowball, L. Soberman, A. L. Stares, Harold Strom, R. D. Stuart, F. L. Taylor, Nathan Tessis, A. Waisglass, G. O. Whitney, J. C. Winlaw, J. C. Wooding, J. G. Woolsley and J. E. Young.

Intermediate: D. P. Aitkens, K. S. Arrell, J. G. Arthur, G. D. Bailey, J. W. Bavis, Douglas Beattie, C. A. Bounsall, T. F. Burton, W. J. Bushnell, Max Cassels, J. H. Charnock, Abe Colman, A. A. Conlin, R. R. Cotton, L. D. Dack, F. L. Day, E. H. Durnan, K. H. Edwards, S. E. Ewens, A. D. Goldman, M. S. Greer, A. E. Guyatt, D. A. Harwood, R. M. Hodgins, D. D. Irwin, J. H. Johnston, L. H. Johnston, M. A. Leroy, R. E. A. Lindsey, J. B. Longmire, W. H. Luton, J. L. MacLeod, E. D. K. Martin, L. M. Morton, D. T. Myers, W. M. Myers, J. L. Newman, J. A. Partridge, A. L. Pettit, G. W. Richardson, P. E. Richardson, M. S. Richman, M. M. Robertson, H. P. Sellers, C. A. Sharpe, J. G. Simonton, R. S. Slater, J. G. Smith, M. S. Soberman, John Spurway, A. N. Steiner, R. R. Sutherland, D. S. Sykes, A. M. Thornhill, H. A. Watson, W. W. White and J. D. Wilson.

Final: J. H. A'Court, J. D. Anderson, M. S. Appleby, S. B. Bartlett, C. M. Beattie, E. D. Berry, S. W. Browne, R. A. Burnes, C. F. Butler, W. E. Butler, W. C. Chick, H.

F. Cumming, M. A. Cunningham, R. J. J. Dallard, A. Davidson, W. W. Davison, Sydney Fox, S. A. Glick, H. S. Glover, M. Goldhar, James Gray, Murray Grossman, A. R. Halladay, W. L. Hammell, C. C. Hopper, W. H. Huck, G. O. Huggan, S. M. Hulbig, P. M. Hutcheson, G. K. L. Hutchings, S. G. Jackson, G. H. Johnson, W. M. Johnston, W. A. Jones, K. W. Lemon, R. A. Levesque, J. R. Lewis, J. A. Little, R. B. Moran, E. B. McLeod, W. T. O'Donnell, Leon Panzer, A. T. Proctor, George Resnick, H. I. Robinson, W. A. Simonton, J. M. M. Simpson, S. G. Simpson, H. H. Sivers, E. B. Smith, C. H. Spry, H. A. Starr, J. C. Taylor, A. D. Ward, B. C. Willis and F. W. Woods.

Supplemental Examinations: The following passed in all but the subjects indicated in the Final examination and have been granted supplemental examinations therein: N. D. Aubin (Accounting I & IV & Economics), J. L. Biddell (Accounting I & III), J. T. Bowles (Accounting III & IV), T. R. Caldwell (all Accounting papers and Economics), W. D. Caskey (Auditing), G. A. Church (Auditing), H. E. Clayton (Auditing), W. J. H. Coggins (Accounting I & IV & Economics), I. H. Coulton (Accounting I & IV), J. B. Currier (Accounting II & IV), N. L. Death (all Accounting papers), K. H. Dunn (Accounting I & III), F. W. Fredenburg (Accounting III & IV), A. Freedman (all Accounting papers), J. S. Grant (Auditing), J. K. Hagan (all Accounting papers), C. H. Hunt (Auditing & Economics), B. K. Jackson (all Accounting papers), L. Kirshenbaum (Auditing & Economics), C. W. Leask (Auditing), E. A. Leftly (all Accounting papers & Economics), A. C. Madgett (Economics), C. B. Maltby (Auditing), W. J. Millyard (all Accounting papers and Economics), J. S. Petrie (Auditing), G. H. Richmond (all Accounting papers), C. G. Robinson (all Accounting papers), R. M. Saunders (all Accounting papers), E. H. Savlov (all Accounting papers), B. T. Stephenson (Accounting I & III & Economics), C. R. Welch (Accounting II & III), R. Williamson, Jr. (all Accounting papers) and H. Wood (all Accounting papers).

Prizes—The Institute announces the following prize winners:

Final: Gold Medal—E. D. Berry, Ottawa; George Edwards Prize—W. A. Simonton, Toronto; W. T. Kernahan Prize—J. A. Little, Toronto; E. R. C. Clarkson Gold Medal—W. A. Greenman (June 1941), Toronto.

Intermediate: First Prize—K. S. Arrell, Toronto; Second Prize—W. J. Bushnell, Toronto.

Primary: First Prize—Saul Marks, Toronto; Second Prize—G. I. Newman, Toronto.

QUEBEC

At a special luncheon meeting held at the Montreal Club on Monday, 16th February, the following successful candidates in the Final examinations of the Provincial Institutes of Chartered Accountants held at McGill University were admitted to membership in The Society of Chartered Accountants of the Province of Quebec: Norton L. Aronson, Patrick H. A. Coristine, James William Fitzpatrick, L. Paul Fournier, Avram H. Garmaise, William Pierce Gould, John Howard Gough, Philip Hollinger, S. Q. M. Horn, Louis O. L'Heureux, William Gore MacKenzie, Warren D. Myers, Solomon Neamtan, James Leonard O'Donnell, Max N. Padber, Murray Alexander Rousell, Saul Reisler, Isidore Stein, Sidney Steinberg, Percy Strean and Solomon Venetsky.

The following successful candidates in the Final examinations held at L'Ecole des Hautes Etudes Commerciales, under the provisions of Act 17, Geo. V, Chapter 46, were also admitted: Arthur Alain, Charles Percy Auger (Quebec City), Herve Beauregard, Hensley Bourgouin, Delphis Clairoux, Roger Dugre, Jacques Nadeau, Joseph Ste. Marie and Jacques Thibaudeau (Quebec City).

After short addresses of welcome by the President, Mr. Wm. H. Campbell, and Mr. Alex. Ballantyne, Past President, certificates of membership were presented, and Philip Hollinger, who obtained the highest marks in the uniform Final examination held at McGill University, was presented with the First War Memorial Prize of the Quebec Society. James William Fitzpatrick, who obtained second highest marks was also presented with a War Memorial Prize. Hensley Bourgouin was presented with a War Memorial Prize for obtaining highest marks in the Final examinations held at L'Ecole des Hautes Etudes Commerciales.

PERSONAL

Archie Prentice Gardner, B.A., chartered accountant, announces that he is now practising his profession under the name of A. P. Gardner & Co. at 509-510 Stock Exchange Building, Vancouver, British Columbia.

OBITUARIES

The Late William Edward Leverman

It is with regret that we record this month the death at Halifax on 22nd January in his 86th year of William Edward Leverman, the last surviving charter member of the Institute of Chartered Accountants of Nova Scotia.

The late Mr. Leverman was elected to membership on 30th March 1900 and in 1910 he began his practice as a chartered accountant which he carried on until his retirement in 1931. He was associated with many of the early organizations of Halifax, being a life member of the Wanderers Club and the City Club and he was possibly the last surviving charter member of the Red Cap Snow Shoe Club formed in 1874. He was also a member of the Masonic Lodge.

To his two sons and two daughters the profession extends sincere sympathy.

The Late John Henry Williams

The Institute of Chartered Accountants of Alberta announces with regret the death at Calgary on 12th February last after a long illness of John Henry Williams.

Mr. Williams was born in London, England, in the year 1882 and had been resident in Canada for about forty years. He became a member of the Institute of Chartered Accountants of Alberta in 1915, was a Member of Council for twenty years in succession, was President in the year 1923-1924 and was elected Fellow of the Institute in the year 1931. He served as Secretary of the Institute from 1927 to 1938 when he was compelled to resign for reasons of health.

Mr. Williams was held in the highest esteem by all who knew him. He has left his mark deep in the affairs of the Alberta Institute and his memory will long live among the members. The Institute extends sincere sympathy to Mrs. Williams and family.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

The Students' Department joins in congratulating all those who were successful in the recent examinations of the several provincial Institutes and in wishing the finalists careers which will be a source of happiness to themselves and inspiration to their fellows.

At the same time, on behalf of all our readers, we send greetings and remembrances to those of our number who have enlisted in the active service forces and so have foregone the opportunity of trying their examinations. We want them to know that they are especially in our thoughts on these occasions and that we look always forward to the happy day when they will be with us again on the student trail.

* * *

Some students experience difficulty with the formulae for the calculation of unit costs in process production when there is work in process at the beginning and end of the cost period. Whatever formula is employed it is necessary to express the quantity of work-in-process as the equivalent of a certain quantity of finished units, or in other words, to calculate the "equivalent performance" of the work in process.

The two commonest formulae may be illustrated simply by supposing that in a certain process there were in process at the beginning of the period 1,000 units, 40% processed and costing $400, that the current outlays for the period were $2,000, that the output of finished product for the period was 1,000 units and that at the end of the period there were 800 units in process, 25% processed. A simple formula but one which allows the costs of the preceding period (as reflected in the opening inventory of work-in-process) to influence the costs of the current period is that which takes the opening inventory cost plus the current outlays as the numerator, and the number of units finished plus the equivalent number of finished units in the closing inventory as the denominator. In the terms of the illustration this gives a unit cost of:

$$\frac{\$400 + \$2{,}000}{1{,}000 + \frac{25}{100}\ (800)} = \$2.00$$

and the ledger account would appear:

Work-in-Process

Opening inventory—1,000 units 40% complete	$ 400	Transfers of finished goods —1,000 units at $2.00 per unit	$2,000
Current outlays	2,000	Closing inventory—800 units 25% complete at $\frac{25}{100}$ ($2.00) per unit ...	400
	$2,400		$2,400
Balance brought down	$ 400		

But since this formula allows the costs of the previous period to affect the calculation of unit costs in the current period it is not a suitable one to employ unless the opening inventory of work-in-process is negligible by comparison with the output during the period. In the illustration this condition is not satisfied and so a more accurate method of computing current costs would be to divide the current outlays by the current performance. The current performance is the numerator of the first formula *less* the equivalent number of finished units in the opening inventory. This formula gives a unit cost of:

$$\frac{\$2{,}000}{1{,}000 + \frac{25}{100}\ (800) - \frac{40}{100}\ (1{,}000)} = \$2.50$$

and the ledger account would appear:

Work-in-Process

Opening inventory—1,000 units 40% complete	$ 400	Transfers to finished goods —1,000 units at $1.90 per unit	$1,900
Current outlays	2,000	Closing inventory—800 units 25% complete at $\frac{25}{100}$ (2.50) per unit	500
	$2,400		$2,400
Balance brought down	$ 500		

It is to be noted that the unit cost computed by this formula is used only in costing the closing inventory of work-in-process. The total cost of the finished units is simply inserted as the residue ($2,400-$500) and the average cost per finished unit is computed from this residuary figure as $\frac{\$1,900}{1,000} = \$1.90$ Alternatively the total cost of the finished units can be computed as though these consisted of $\frac{40}{100}$ (1,000) units at the unit cost of the previous period ($1.00) and $\frac{60}{100}$ (1,000) units at the current unit cost ($2.50).

This second formula can safely be used in all circumstances except those where there is *avoidable* wastage in processing when the denominator of this formula should be modified to give the number of units that should have been produced in place of the number of units actually produced. The cost of the number of units wasted is then written off as a loss and is not allowed to affect the valuation either of finished units or of units wasted. However in most processing in which wastage occurs the wastage is inherent and is really a shrinkage rather than a wastage.

It need only be added that in practice it is usually necessary to make separate calculations for each of the three elements of cost, raw materials, direct labour and factory service.

* * *

PROBLEMS AND SOLUTIONS

EXAMINATIONS OF THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

FINAL EXAMINATION, JUNE 1941

Accounting II, Question 2 (25 marks)

Prepare a report to the directors of a company, commenting on its operating results for the year ended 31st December 1940, which are set out below in comparative form with those of the previous year:

	Year ended 31st December 1940	Year ended 31st December 1939
Sales	$1,400,000	$1,400,000
Cost of sales*	1,000,000	975,000
	400,000	425,000
Underabsorbed factory overhead	20,000	10,000
Gross profit	380,000	415,000
Less Expenses:		
Selling and delivery	200,000	200,000
Warehouse	25,000	20,000
Administration	80,000	65,000
	305,000	285,000
Profit before taxes on income	75,000	130,000
Less Provision for income and excess profits taxes	26,250	26,000
Net profit	$ 48,750	$ 104,000

*Excluding underabsorbed factory overhead.

You obtain the following supplementary information:

(1) The company manufactures and sells only one product which was not changed in any way during 1939 or 1940;

(2) Sales were analyzed as follows:

	1940	1939
Domestic	$1,000,000	$ 900,000
Export	400,000	500,000
	$1,400,000	$1,400,000

(3) Cost of sales was arrived at as follows:

	1940	1939
Cost of goods manufactured:		
Material	$ 510,000	$ 525,000
Labour	360,000	350,000
Overhead absorbed	180,000	175,000
	1,050,000	1,050,000
Opening inventory	300,000	225,000
	1,350,000	1,275,000
Closing inventory	350,000	300,000
	$1,000,000	$ 975,000

(4) Quantities sold, produced, etc. during the two years were as follows:

	1940 Units	1939 Units
Sold:		
Domestic	200,000	200,000
Export	100,000	125,000
	300,000	325,000
Produced	300,000	350,000
Opening inventory	100,000	75,000
Closing inventory	100,000	100,000

SOLUTION

The Directors,
...............Company Limited,
Canada.

Dear Sirs:

Attached hereto are comparative operating statements of your company for the years ended 31st December 1940 and 1939. While sales were maintained at $1,400,000, the net profit for the year was reduced from $104,000 to $48,750, or by $55,250. This was attributable to the following:

(1) Reduced gross profit	$35,000
(2) Increased expenses	20,000
(3) Increased provision for expenses	250
	$55,250

We discuss these hereunder.

(1) *Gross profit—reduced by $35,000*

While sales for the year were maintained at the same dollar value as previously, quantities sold were reduced from 325,000 units to 300,000 units—the reduction of 25,000 units being entirely in the export market. During the year costs increased substantially—the cost of goods manufactured having increased from $3 to $3.50 per unit. Some units were carried forward from the previous year so that the average cost of sales shows an increase from $3 to $3.33 1/3 per unit. In the export market your selling price was not increased so that on the 100,000 units which you sold the additional 33 1/3c cost amounted to $33,333

In addition your sales in the export market were 25,000 units less than in 1939. In that year your gross profit on such sales was $1, (the selling price being $4 and cost $3). The gross profit thus lost totalled 25,000

A total reduction in gross profit on export business of $58,333

In the domestic market you maintained your sales volume at 200,000 units. While costs increased by 33 1/3c per unit as noted above, the selling price increased by 50c a unit, so that the gross profit was 16 2/3c more. On the 200,000 units sold this totalled 33,333

The net reduction in gross profits was, therefore, only	$25,000
Factory overhead expenses were $15,000 greater than in the previous year. Because factory overhead is absorbed in direct proportion to direct labour and total payrolls increased slightly, the factory overhead absorbed in 1940 was $5,000 more than in 1939. As a result the unabsorbed overhead increased by only	10,000
A net reduction in gross profit of	$35,000

(2) *Expenses—increased by $20,000*

The increase in expenses of $20,000 was divided as follows:

Warehouse	$ 5,000
Administration	15,000
	$20,000

This increase was attributable to (particulars not given in question)

(3) *Provision for taxes—increased by $250*

In spite of the substantial reduction in the profit before taxes on income, from $130,000 in 1939 to $75,000 in 1940, the provision for income and excess profits taxes was actually $250 greater. This is due to the imposition of the excess profits tax in 1940 and an increase in the rate of Dominion income tax. In 1939 the provision for tax was estimated at 20% of the taxable income. In 1940 the provision amounts to 35%. This is predicated upon your company being taxable for excess profits tax at the minimum rate of 12% provided under the Act.

Yours faithfully,

PROBLEM II

FINAL EXAMINATION, JUNE 1941

Accounting IV, Question 4 (20 marks)

The balance sheets of companies A, B & C are given below. These companies have been approached by a syndicate with a proposal that a consolidation be effected, and that a new company be formed for the purpose under the name of the Inter-Provincial Manufacturing Co. Limited.

The syndicate members have interviewed a firm of investment bankers who are prepared to underwrite, at 98½, a 5% bond issue of $750,000 secured by a first mortgage on the combined properties and plants of the three companies. The syndicate proposes to obtain a charter for the new company with an authorized capital of 7,000 shares of 6% preferred stock, par value $100, and 50,000 shares of common stock of no par value.

The terms of the offer made by the syndicate are:

(a) That $213,750 of the cash received from the sale of bonds shall be retained for additional working capital, and the remainder given to the old companies as part payment of the purchase price.

(b) That the whole of the preferred stock and 25,000 shares of

the common stock shall be issued to the old companies in settlement of the balance of the purchase price.

(c) The syndicate to pay all expenses of organization (except bond discount) and expenses of dissolution of the old companies, and as consideration for its services and expenditures, is to be allotted 5,000 shares of no par value common stock at a price of $10 per share, with an option on the remaining 20,000 at $25 per share, said option to be good for two years.

(d) The cash and preferred stock to be issued to the three companies pro-rata to their net tangible assets, after revaluation.

(e) In valuing goodwill the normal return on capital shall be taken as 7%, and excess or super-profits capitalized at 10%.

Condensed Balance Sheets

	A	B	C
Cash	$ 22,000	$ 58,000	$ 6,000
Accounts and bills receivable, less reserve	200,000	190,000	70,000
Inventories	318,000	220,000	96,000
Land	50,000	45,000	30,000
Buildings, plant and machinery	624,000	485,000	273,000
Goodwill			30,000
	$1,214,000	$998,000	$505,000
Accounts and bills payable	$ 248,000	$276,000	$138,000
Reserve for depreciation	244,000	172,000	116,000
Capital stock	450,000	500,000	150,000
Earned surplus	272,000	50,000	101,000
	$1,214,000	$998,000	$505,000

The proposal having been favourably received, the syndicate employed a firm of appraisers who report as follows:

	A	B	C
Present value of land	$ 66,000	$ 42,000	$ 35,000
Replacement value of buildings, plant and machinery	806,000	546,000	284,000
Accrued depreciation	268,000	166,000	101,000

An independent firm of accountants is also employed and they certify that the adjusted net profits of the three companies have averaged for the last five years: A, $68,750; B, $48,050; C, $31,200. Their report further states:

(a) The reserve for bad debts of B Company should be increased by $5,000;

(b) Additional provision of $7,000 should be made by A Company for estimated liability for additional taxes;

(c) There has been no change in capital accounts during the past five years, and dividends paid during the five years, and dividends paid during the five years have approximated the profits earned.

REQUIRED:

(a) Show what disposition you would make of the purchase consideration—cash, preferred shares and common shares (to nearest ten shares) to the three companies.

(b) Draw up the opening balance sheet of the new company. No goodwill is to be shown in the new company's accounts.

SOLUTION

(a) Item	A	B	C	TOTAL
Tangible assets (net)				
Cash	$ 22,000	$ 58,000	$ 6,000	$ 86,000
Accounts and bills receivable	200,000	185,000	70,000	455,000
Inventories	318,000	220,000	96,000	634,000
Land	66,000	42,000	35,000	143,000
Buildings and plant less depreciation	538,000	380,000	183,000	1,101,000
	1,144,000	885,000	390,000	2,419,000
Accounts and bills payable	255,000	276,000	138,000	669,000
Total	$ 889,000	$ 609,000	$ 252,000	$1,750,000
Paid in cash	266,700	182,700	75,600	525,000
Paid in preferred stock	355,600	243,600	100,800	700,000
	$ 622,300	$ 426,300	$ 176,400	$1,225,000
Balance to be settled by common stock	266,700	182,700	75,600	525,000
Add: Goodwill (see below)	65,200	54,200	135,600	255,000
Total values to be settled by common shares	$ 331,900	$ 236,900	$ 211,200	$ 780,000
Computation of Goodwill				
Assets employed	$ 889,000	$ 609,000	$ 252,000	$1,750,000
7% thereon	62,230	42,630	17,640	122,500
Average earnings	68,750	48,050	31,200	148,000
Excess earnings	$ 6,520	$ 5,420	$ 13,560	$ 25,500
Capitalized at 10%	$ 65,200	$ 54,200	$ 135,600	$ 255,000

Division of 25,000 shares

Total value for 25,000 shares $780,000 = $31.20 per share

A Company: $331,900 ÷ 31.20 = 10,638

B Company: $236,900 ÷ 31.20 = 7,593

C Company: $211,200 ÷ 31.20 = 6,769
Division of common shares (to nearest 10)

A	10,640
B	7,590
C	6,770
	25,000

(b) INTER-PROVINCIAL MANUFACTURING CO. LIMITED

BALANCE SHEET

Assets

Current:		
Cash	$ 349,750	
Accounts and bills receivable less reserve	455,000	
Inventories	634,000	$1,438,750
Fixed: (at values as appraised by — as at —)		
Land	143,000	
Buildings, plant & machinery	1,101,000	1,244,000
Deferred Charges:		
Bond discount		11,250
		$2,694,000

Liabilities

Current:	
Accounts and bills payable	$ 669,000
Bonds, First mortgage 5%	750,000
Preferred shares: Authorized and issued: 7,000 shares of $100 each	700,000
Common shares: Authorized: 50,000 shares of no par value Issued: 30,000 shares	575,000
(an option has been given on the unissued 20,000 shares at $25 per share, good until)	
	$2,694,000

PROBLEM III

FINAL EXAMINATION, JUNE 1941

Accounting IV, Question 5 (15 marks)

A manufacturing company suffered a disastrous fire which badly damaged its plant and contents.

The company's fiscal year ends 31st December, and at the time of the fire its books showed the following:

Land (at cost)	$ 35,000
Buildings (at cost)	110,000
Machinery (at cost)	200,000
Raw materials and supplies (book inventory 1st November 1940)	20,000
Work-in-process	10,000
Finished goods (book inventory 1st November 1940)	70,000
Depreciation reserve—buildings (as of 1st January 1940)	22,000
Depreciation reserve—machinery (as of 1st January 1940)	80,000

The company had insured the buildings, machinery and stock under a blanket policy for $300,000 with a 90% co-insurance clause. The annual premium is $1,800 and covers a year from 1st May 1940. The fire took place on 1st November 1940.

The loss adjusters accepted the inventory figures as shown by the company's records as representing the replacement value of the stock. The actual values of the buildings and machinery at the time of the fire were determined to be:

Buildings	$ 90,000
Machinery	150,000

and the loss was determined to be:

Buildings	$ 30,000
Machinery	80,000
Raw material and supplies	15,000
Work-in-process	8,000
Finished goods	25,000

The original cost of the buildings and machinery destroyed was:

Buildings	$ 35,000
Machinery	130,000

(a) What amount is the insured entitled to recover from the insurance company?

(b) Set up the journal entries necessary to record completely this loss. (The annual rates of depreciation used by the company are: Buildings, 5% on cost; Machinery, 10% on cost. It may be assumed that all items in the buildings and machinery accounts, respectively, have been equally depreciated.)

Do not carry computations beyond the nearest dollar.

SOLUTION

(a)

Insurable values at time of fire:

Buildings	$ 90,000	
Machinery	150,000	
Raw material and supplies	20,000	
Work-in-process	10,000	
Finished goods	70,000	
	$340,000	
90% thereof	306,000	
Insurance carried	300,000	

Insurance company pays $\frac{300}{306}$ of the loss:

Loss:

Buildings	$ 30,000	
Machinery	80,000	
Raw material and supplies	15,000	
Work-in-process	8,000	
Finished goods	25,000	
	$158,000	
Recoverable amount—300/306 x 158,000 =	$154,902	

(b)

Account receivable—Insurance claim	$154,902	
Fire loss and damage account		$154,902
Setting up claim against insurance company		
Fire loss and damage account	213,000	
Buildings		35,000
Machinery		130,000
Raw material and supplies		15,000
Work-in-process		8,000
Finished goods		25,000
Transferring from asset accounts the book value of the property destroyed		
Profit and loss	12,291	
Depreciation reserve—buildings		1,458
Depreciation reserve—machinery		10,833
Setting up depreciation on assets destroyed for 10 months to 1st November 1940		
Depreciation reserve—buildings	8,458	
Depreciation reserve—machinery	62,833	
Fire loss and damage account		71,291
Transferring depreciation on assets destroyed from the depreciation reserves		
Fire loss and damage	465	
Insurance		465

Writing off cancelled portion of unexpired premium at 1st November 1940 as policy reduced by payment of loss $154,902			
Unexpired portion of total premium at 1st November 1940	$900		
154,902/300,000 x 900	465		
Fire loss and damage		12,728	
Surplus			12,728
Transferring to surplus net amount received in excess of book values of assets destroyed			

Fire Loss and Damage Account

	Dr.	*Cr.*
Claim on insurance company		$154,902
Assets transferred	$213,000	
Depreciation reserve		71,291
Insurance unexpired	465	
Profit and loss	12,728	
	$226,193	$226,193